

## **ORION POWER HOLDINGS, INC. AND SUBSIDIARIES**

**As of March 31, 2007 and December 31, 2006 and For the Three Months Ended March 31, 2007 and 2006**

- Forward-Looking Information
- Financial Statements
- Management's Discussion and Analysis of Financial Condition and Results of Operations
- Quantitative and Qualitative Disclosures About Market Risk

## **FORWARD-LOOKING INFORMATION**

Projections, estimates or assumptions about revenues, costs, income, cash flow and other future events are called “forward-looking statements.” In some cases, you can identify forward-looking statements by words like “anticipate,” “estimate,” “believe,” “intend,” “may,” “expect” or similar words. Forward-looking statements are not guarantees of future performance. Actual results may differ from forward-looking statements. Each forward-looking statement speaks only as of its date and we are under no obligation to update these statements.

**ORION POWER HOLDINGS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Thousands of Dollars)  
(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>Revenues:</b>		
Revenues.....	\$ 8,341	\$ 4,557
Revenues – affiliates.....	135,971	113,913
Total.....	<u>144,312</u>	<u>118,470</u>
<b>Expenses:</b>		
Fuel and purchased power .....	59,919	57,004
Fuel and purchased power – affiliates .....	622	60
Operation and maintenance .....	42,089	23,353
Operation and maintenance – affiliates.....	9,490	7,645
Taxes other than income taxes.....	3,192	3,304
General and administrative – primarily affiliates .....	7,406	6,555
Gains on sales of assets and emission allowances, net – primarily affiliates .....	(3,169)	(66,522)
Depreciation.....	18,969	18,258
Amortization.....	2,149	2,341
Total operating expenses.....	<u>140,667</u>	<u>51,998</u>
<b>Operating Income</b> .....	<u>3,645</u>	<u>66,472</u>
<b>Other Income (Expense):</b>		
Other, net.....	–	47
Interest expense .....	(9,418)	(9,669)
Interest expense – affiliates.....	(1,583)	–
Interest income – primarily affiliates.....	2,534	1,395
Total other expense.....	<u>(8,467)</u>	<u>(8,227)</u>
<b>Income (Loss) from Continuing Operations Before Income Taxes</b> .....	<u>(4,822)</u>	<u>58,245</u>
Income tax expense (benefit).....	(1,841)	24,556
<b>Income (Loss) from Continuing Operations</b> .....	<u>(2,981)</u>	<u>33,689</u>
Income (loss) from discontinued operations.....	(1,652)	12,020
<b>Net Income (Loss)</b> .....	<u>\$ (4,633)</u>	<u>\$ 45,709</u>

See Notes to the Unaudited Consolidated Interim Financial Statements

**ORION POWER HOLDINGS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(Thousands of Dollars, Except Share and Per Share Amounts)

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
<b>ASSETS</b>	<b>(Unaudited)</b>	
<b>Current Assets:</b>		
Cash and cash equivalents .....	\$ 925	\$ 81
Accounts receivable, principally customer .....	57	1,664
Receivables from affiliates, net .....	32,011	33,046
State income taxes receivable .....	10,099	10,084
Inventory .....	47,092	50,289
Accumulated deferred income taxes .....	8,039	7,359
Collateral posted under agreement with Reliant Energy, Inc. ....	2,536	3,278
Prepayments and other current assets .....	4,933	6,390
Current assets of discontinued operations .....	2,567	2,460
Total current assets .....	108,259	114,651
Property, plant and equipment, gross .....	1,950,353	1,928,491
Accumulated depreciation .....	(358,874)	(340,606)
<b>Property, Plant and Equipment, net</b> .....	<b>1,591,479</b>	<b>1,587,885</b>
<b>Other Assets:</b>		
Goodwill .....	173,570	175,520
Other intangibles, net .....	180,397	183,163
Long-term note receivable from Reliant Energy, Inc. ....	92,200	92,200
Long-term collateral posted under agreement with Reliant Energy, Inc. ....	12,326	12,326
Other .....	54,444	59,615
Total other assets .....	512,937	522,824
<b>Total Assets</b> .....	<b>\$ 2,212,675</b>	<b>\$ 2,225,360</b>
<b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>		
<b>Current Liabilities:</b>		
Current portion of long-term debt .....	\$ 10,690	\$ 10,505
Accounts payable, principally trade .....	34,763	29,594
Accrued interest payable .....	20,008	7,996
Other taxes payable .....	10,224	10,910
Other .....	6,145	9,335
Current liabilities of discontinued operations .....	3,383	3,286
Total current liabilities .....	85,213	71,626
<b>Other Liabilities:</b>		
Accumulated deferred income taxes .....	189,829	178,042
Benefit obligations .....	53,341	58,100
Taxes payable to Reliant Energy, Inc. ....	72,043	84,310
Other .....	9,369	11,043
Total other liabilities .....	324,582	331,495
<b>Revolving Credit Facility with Reliant Energy, Inc.</b> .....	415	12,683
<b>Long-term Debt</b> .....	425,551	428,343
<b>Commitments and Contingencies</b>		
<b>Stockholder's Equity:</b>		
Common stock; par value \$1.00 per share (1,000 shares authorized, issued and outstanding) .....	1	1
Additional paid-in capital .....	2,211,139	2,211,139
Retained deficit .....	(827,207)	(823,693)
Accumulated other comprehensive loss .....	(7,019)	(6,234)
Total stockholder's equity .....	1,376,914	1,381,213
<b>Total Liabilities and Stockholder's Equity</b> .....	<b>\$ 2,212,675</b>	<b>\$ 2,225,360</b>

See Notes to the Unaudited Consolidated Interim Financial Statements

**ORION POWER HOLDINGS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Thousands of Dollars)  
(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>Cash Flows from Operating Activities:</b>		
Net income (loss).....	\$ (4,633)	\$ 45,709
(Income) loss from discontinued operations.....	1,652	(12,020)
Net income (loss) from continuing operations.....	(2,981)	33,689
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization.....	21,118	20,599
Deferred income taxes.....	10,428	3,821
Net unrealized losses on derivatives.....	793	–
Net amortization of contractual rights and obligations.....	(131)	(1,286)
Amortization of revaluation of acquired debt.....	(2,607)	(2,428)
Gains on sales of assets and emission allowances, net – primarily affiliates.....	(3,169)	(66,522)
Non-cash federal income tax contributions from Reliant Energy, Inc., net.....	–	15,854
Other, net.....	–	(523)
Changes in other assets and liabilities:		
Accounts receivable, net.....	1,607	986
Inventory.....	2,754	(1,776)
Other current assets.....	(202)	728
Other assets.....	6,045	(1,030)
Accounts payable.....	(517)	6,303
Payable to/receivable from affiliates, net.....	1,034	(925)
Collateral returned under agreement with Reliant Energy, Inc.....	742	–
Income taxes payable/receivable.....	(15)	3,476
Accrued interest payable.....	12,012	11,990
Long-term taxes payable to Reliant Energy, Inc.....	(12,267)	–
Other current liabilities.....	(3,812)	(2,710)
Other liabilities.....	(2,966)	1,798
Net cash provided by continuing operations from operating activities.....	27,866	22,044
Net cash provided by (used in) discontinued operations from operating activities.....	(1,664)	12,395
Net cash provided by operating activities.....	26,202	34,439
<b>Cash Flows from Investing Activities:</b>		
Capital expenditures.....	(16,876)	(8,791)
Proceeds from sales of emission allowances – affiliates.....	3,786	60,038
Net cash provided by (used in) continuing operations from investing activities.....	(13,090)	51,247
Net cash provided by discontinued operations from investing activities.....	–	967,743
Net cash provided by (used in) investing activities.....	(13,090)	1,018,990
<b>Cash Flows from Financing Activities:</b>		
Payments of long-term debt.....	–	(191)
Distributions to Reliant Energy, Inc.....	–	(209,400)
Loan to Reliant Energy, Inc.....	–	(92,200)
Changes in revolving credit facility with Reliant Energy, Inc., net.....	(12,268)	–
Net cash used in continuing operations from financing activities.....	(12,268)	(301,791)
Net cash used in discontinued operations from financing activities.....	–	(712,317)
Net cash used in financing activities.....	(12,268)	(1,014,108)
<b>Net Change in Cash and Cash Equivalents.....</b>	<b>844</b>	<b>39,321</b>
<b>Cash and Cash Equivalents at Beginning of Period.....</b>	<b>81</b>	<b>13,752</b>
<b>Cash and Cash Equivalents at End of Period.....</b>	<b>\$ 925</b>	<b>\$ 53,073</b>
<b>Supplemental Disclosure of Cash Flow Information:</b>		
Cash Payments:		
Interest paid (net of amounts capitalized) to third parties for continuing operations.....	\$ 9	\$ 203
Income taxes paid (net of income tax refunds received) for continuing operations.....	15	1,477
Non-cash Disclosure:		
Contributions from Reliant Energy, Inc., net for continuing operations.....	–	15,854
Contributions from Reliant Energy, Inc., net for discontinued operations.....	–	144,611

See Notes to the Unaudited Consolidated Interim Financial Statements

## ORION POWER HOLDINGS, INC. AND SUBSIDIARIES

### NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

#### (1) Background and Basis of Presentation

##### (a) Background.

“Orion Power” refers to Orion Power Holdings, Inc. (Orion Power Holdings) and its consolidated subsidiaries. Orion Power Holdings is a wholly-owned subsidiary of Reliant Energy, Inc. “Reliant Energy” refers to Reliant Energy, Inc. and its consolidated subsidiaries. These interim financial statements and notes (interim financial statements) are unaudited, omit certain disclosures and should be read in conjunction with the audited consolidated financial statements and notes for the three years ended December 31, 2006 (2006 annual consolidated financial statements).

##### (b) Basis of Presentation.

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

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

*Adjustments and Reclassifications.* The interim financial statements reflect all normal recurring adjustments necessary, in management’s opinion, to present fairly Orion Power’s financial position and results of operations for the reported periods. Amounts reported for interim periods, however, may not be indicative of a full year period due to seasonal fluctuations in demand for electricity and energy services, changes in commodity prices, timing of maintenance and other expenditures, dispositions, changes in interest expense and other factors. Orion Power has reclassified certain immaterial amounts reported in this report from prior periods to conform to the 2007 presentation. These reclassifications had no impact on reported earnings/losses.

#### (2) Related Party Transactions

These financial statements include the impact of significant transactions between Orion Power and Reliant Energy. The majority of these transactions involve the purchase or sale of energy, capacity, fuel, emission allowances or related services (including transportation, transmission and storage services) from or to Orion Power and allocations of costs to Orion Power for support services.

*Support Services.* Reliant Energy provides commercial support, technical services and other corporate services to Orion Power. Reliant Energy allocates certain support services costs to Orion Power based on Orion Power’s underlying planned operating expenses relative to the underlying planned operating expenses of other entities to which Reliant Energy provides similar services and also charges Orion Power for certain other services based on usage. Management believes this method of allocation is reasonable. These allocations and charges were not necessarily indicative of what would have been incurred had Orion Power been an unaffiliated entity.

The following details the amounts recorded as operation and maintenance – affiliates and general and administrative – affiliates:

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(in millions)</b>	
Allocated or charged by Reliant Energy.....	\$ 17	\$ 14

*Commodity Procurement and Marketing.* Orion Power has sales to and purchases from Reliant Energy related to commodity procurement and marketing services.

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	(in millions)	
Sales to Reliant Energy under various commodity agreements <sup>(1)</sup> .....	\$ 136	\$ 114
Purchases from Reliant Energy under various commodity agreements <sup>(2)</sup> .....	2	2
Net sales of coal to Reliant Energy <sup>(3)</sup> .....	4	4
Gains on coal sales to Reliant Energy <sup>(4)</sup> .....	1	2
Sales of emission allowances to Reliant Energy <sup>(5)</sup> .....	4	69
Gains on emission allowances sales to Reliant Energy <sup>(6)</sup> .....	3	67

(1) Recorded in revenue – affiliates.

(2) Recorded in fuel and purchased power – affiliates. Amounts include purchases from an affiliate to meet requirements of contractual commitments.

(3) Reflects market price of coal at sale and purchase dates.

(4) Recorded in fuel and purchased power – affiliates.

(5) Reflects price at which Reliant Energy sold the emission allowances to third-parties.

(6) Recorded in gains on sales of assets and emission allowances, net. See note 10.

*Debt Obligations from/to Reliant Energy.* In December 2004, Orion Power Midwest, L.P. (Orion MidWest) entered into the following with Reliant Energy: (a) two related-party notes for a total of \$400 million and (b) a \$75 million revolving credit facility. In December 2004, Orion Power New York, L.P. (Orion New York) entered into the following with Reliant Energy: (a) a related-party note for \$400 million and (b) a \$50 million revolving credit facility. The Orion MidWest and Orion New York related party notes bore interest at 6.5% per year and interest was payable monthly. The revolving credit facilities bore interest at London Inter Bank Offering Rate (LIBOR) plus 2.875%. Some of these amounts were classified as discontinued operations. See note 11. In connection with the sales of the New York plants and the Ceredo plant, the related party notes were paid off and the Orion New York revolving credit facility was terminated. The \$75 million Orion MidWest revolving credit facility matures in December 2007; however, Reliant Energy plans to extend the maturity each December for 12 months from that date. In March 2006, Orion Power made a term loan to Reliant Energy for \$92 million, which matures in 2010. The note bears interest at ten percent and interest is payable monthly.

*Secured Revolving Letter of Credit Facility Agreement with Reliant Energy.* Reliant Energy posts letters of credit on behalf of Orion Power. As of March 31, 2007 and December 31, 2006, Reliant Energy posted letters of credit totaling \$15 million and \$16 million, respectively, on behalf of Orion Power. During September 2006, Reliant Energy and Orion Power entered into a Secured Revolving Letter of Credit Facility Agreement whereby Orion Power will provide cash to Reliant Energy as collateral for letters of credit when issued up to a maximum of \$20 million. The agreement expires on April 30, 2010. As letters of credit expire, the cash collateral will be returned to Orion Power. Orion Power will reimburse Reliant Energy for the costs of the letters of credit and will earn interest income on the collateral posted. As of March 31, 2007 and December 31, 2006, Orion Power has provided cash collateral of \$15 million and \$16 million, respectively, to Reliant Energy. During the three months ended March 31, 2007, the letters of credit costs, recorded in interest expense, and the related interest income were insignificant.

*Distributions to Reliant Energy.*

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	(in millions)	
Orion Power Holdings distributions to Reliant Energy <sup>(1)</sup> .....	\$ –	\$ (209)

(1) Related to cash from Orion Power's business operations or asset sales. See note 11(a).

*Income Taxes.*

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	(in millions)	
Non-cash contribution from (distributions to) Reliant Energy related to federal income taxes for continuing and discontinued operations .....	\$ —	\$ 160

As of March 31, 2007 and December 31, 2006, Orion Power has \$72 million and \$84 million, respectively, recorded as long-term taxes payable to Reliant Energy, Inc. For discussion of Orion Power's policy with respect to income taxes and long-term taxes payable to Reliant Energy, Inc., see note 2(j) to the 2006 annual consolidated financial statements.

**(3) Comprehensive Income (Loss)**

The components of total comprehensive income (loss) are:

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	(in millions)	
Net income (loss).....	\$ (5)	\$ 46
Other comprehensive income (loss), net of tax:		
Deferred loss from cash flow hedges.....	—	(4)
Reclassification of net deferred gain from cash flow hedges realized in net income/loss .....	(1)	(6)
Comprehensive income (loss).....	<u>\$ (6)</u>	<u>\$ 36</u>

**(4) Goodwill**

*2007 Annual Goodwill Impairment Test.* Orion Power is in the process of performing its annual goodwill impairment test effective April 1, 2007.

*Estimation of Fair Value.* Orion Power anticipates using substantially the same subjective factors and significant assumptions to estimate fair value in its 2007 test as it used in the April 2006 test. See note 4 to the 2006 annual consolidated financial statements.

**(5) Derivative Instruments**

For discussion of Orion Power's derivative activities, see notes 2(d) and 5 to the 2006 annual consolidated financial statements.

During the three months ended March 31, 2007 and 2006, there was no hedge ineffectiveness recognized from derivatives that were designated and qualified as cash flow hedges. In addition, no component of the derivatives' gain or loss was excluded from the assessment of effectiveness for these periods. If it becomes probable that an anticipated transaction will not occur, Orion Power realizes in net income (loss) the deferred gains and losses recognized in accumulated other comprehensive loss. During the three months ended March 31, 2007 and 2006, no amount was recognized in the results of continuing operations as a result of the discontinuance of cash flow hedges because it was probable that the forecasted transaction would not occur.

During the third quarter of 2006, Orion Power de-designated its remaining cash flow hedges; therefore, as of March 31, 2007 and December 31, 2006, Orion Power has no cash flow hedges. As of March 31, 2007 and December 31, 2006, accumulated other comprehensive income from derivatives was \$2 million and \$3 million, respectively. As of March 31, 2007, Orion Power expects \$2 million of accumulated other comprehensive income to be reclassified into its results of operations during the period from April 1, 2007 to March 31, 2008.

## (6) Debt

Orion Power's outstanding debt to third parties is:

	March 31, 2007			December 31, 2006		
	Stated Interest Rate <sup>(1)</sup>	Long-term	Current	Stated Interest Rate <sup>(1)</sup>	Long-term	Current
		(in millions, except interest rates)				
Orion Power Holdings senior notes due 2010 (unsecured) .....	12.00	\$ 400	\$ –	12.00	\$ 400	\$ –
Adjustment to fair value of debt <sup>(2)</sup> .....		26	10		29	10
Total debt .....		<u>\$ 426</u>	<u>\$ 10</u>		<u>\$ 429</u>	<u>\$ 10</u>

(1) The stated interest rates are of March 31, 2007 or December 31, 2006.

(2) Included in interest expense is amortization of \$3 million and \$2 million for valuation adjustments for debt during the three months ended March 31, 2007 and 2006, respectively.

See note 2 for discussion of Orion Power's debt obligations to Reliant Energy.

## (7) Income Taxes

### (a) Tax Rate Reconciliation.

A reconciliation of the federal statutory income tax rate to the effective income tax rate is:

	Three Months Ended March 31,	
	2007	2006
Federal statutory rate .....	35%	35%
Additions (reductions) resulting from:		
State income taxes, net of federal income taxes .....	4	8
Other, net .....	(1)	(1)
Effective rate .....	<u>38%</u>	<u>42%</u>

### (b) Adoption of FIN 48 and Tax Uncertainties.

Effective January 1, 2007, Orion Power adopted Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," (FIN 48). This interpretation addresses whether (and when) tax benefits claimed in Orion Power's tax returns should be recorded in the financial statements. Pursuant to FIN 48, Orion Power may only recognize the tax benefit from an "uncertain tax position" when it is more-likely-than-not that, based on the technical merits, the position will be sustained by taxing authorities or the courts. The recognized tax benefits are measured as the largest benefit having a greater than fifty percent likelihood of being sustained upon settlement. FIN 48 also provides guidance for derecognition, classification, interest and penalties, disclosures and related matters. Orion Power classifies accrued interest and penalties related to uncertain income tax positions in income tax expense/benefit.

In connection with the adoption, Orion Power recognized the following in its consolidated financial statements:

	Adoption Effect on	
	January 1, 2007	
	Increase (Decrease)	
	(in millions)	
Goodwill .....	\$	(2)
Other long-term liabilities .....		(3)
Retained deficit .....		(1)

As of January 1, 2007, immediately after adoption, Orion Power's consolidated balance sheet reflected \$0 for income tax uncertainties. As of March 31, 2007, Orion Power has accrued \$0 for uncertain income tax positions.

Reliant Energy's income tax returns for the 1997 to 2005 tax reporting periods are under audit by federal and state taxing authorities. These audits may result in additional taxes, interest and penalties or revisions of the timing of tax payments. As Orion Power is a part of the consolidated income tax returns of Reliant Energy, it could be subject to additional taxes. Orion Power does not currently estimate that its unrecognized tax benefits will change significantly within the next 12 months.

#### **(8) Guarantees and Indemnifications**

*Equity Pledged as Collateral to Reliant Energy.* Orion Power Holdings' equity is pledged as collateral under certain of Reliant Energy's credit and debt agreements, which have an outstanding balance of \$2.8 billion as of March 31, 2007.

*Interests Pledged as Collateral to Reliant Energy.* In connection with Orion Power's debt to Reliant Energy (as discussed in note 2), Orion Power Holdings has pledged its interests in Orion Power Capital, LLC, and its subsidiaries, including Orion New York and Orion MidWest, to Reliant Energy. In connection with the sale of the New York plants the related interests were released.

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

Orion Power is unable to estimate its maximum potential exposure under these provisions until an event triggering payment under these provisions occurs. Orion Power does not expect to make any material payments under these provisions.

#### **(9) Contingencies**

Orion Power is involved in a number of legal, environmental and other matters before courts and governmental agencies, some of which may involve substantial amounts. Unless otherwise noted, Orion Power cannot predict the outcome of these matters.

*New Source Review Matters.* The United States Environmental Protection Agency (EPA) and various states are investigating compliance of coal-fueled electric generating stations with the "New Source Review" requirements of the Clean Air Act. The EPA has agreed to share information relating to its investigations with state environmental agencies.

*Ash Disposal Site Closures.* Orion Power is responsible for environmental costs related to the future closures of two ash disposal sites owned by Orion MidWest. Based on Orion Power's evaluations with assistance from third-party consultants and engineers, Orion Power recorded the estimated discounted costs associated with these environmental liabilities as part of its asset retirement obligations. See note 2(o) to the 2006 annual consolidated financial statements.

*New Castle Notice of Violation.* In December 2006, Orion MidWest received a Notice of Violation from the Pennsylvania Department of Environmental Protection regarding the elevation of the permitted coal ash landfill at its generating site in New Castle, Pennsylvania. Orion Power is currently negotiating a penalty amount with the agency, which Orion Power estimates will be approximately \$100,000.

*Water Quality.* In late March 2007, the EPA issued a notice that its final regulations relating to the design and operation of cooling water intake structures at existing power plants should be considered suspended. This action was in response to the Second Circuit Court of Appeals' January 2007 remand of the regulations for substantial revisions. The EPA also instructed that any requirements for design, construction and operation of cooling water intake structures be assessed on a plant-by-plant basis on a best professional judgment basis as permits are renewed.

## (10) Sales of Assets and Emission Allowances

*Emission Allowances.* Sales consist of:

	Three Months Ended March 31,	
	2007	2006
	(in millions)	
SO <sub>2</sub> <sup>(1)</sup> allowances.....	\$ 4 <sup>(2)</sup>	\$ 69 <sup>(3)(4)</sup>
	<u>\$ 4</u>	<u>\$ 69</u>

(1) SO<sub>2</sub> is sulfur dioxide.

(2) Sold 8,000 tons to an affiliate relating to 2007 vintage year.

(3) Sold 45,000 tons to an affiliate relating to 2007 through 2009 vintage years.

(4) Amount includes \$9 million of accounts receivable – affiliate related to sales of emission allowances.

*Summary of Gains and Losses.*

	Three Months Ended March 31,	
	2007	2006
	(in millions)	
Emission allowances.....	\$ 3	\$ 67
Gains on sales of assets and emission allowances, net .....	<u>\$ 3</u>	<u>\$ 67</u>

## (11) Discontinued Operations

### (a) New York Plants.

*General.* In February 2006, Orion Power closed on the sale of its three remaining New York plants with an aggregate net generating capacity of approximately 2,100 megawatts (MW) for \$979 million. During the third quarter of 2005, Orion Power began to report the results of the New York plants as discontinued operations.

*Use of Proceeds.* Orion Power applied \$704 million of cash proceeds, which is net of estimated city, state and transfer taxes and transaction costs, to pay down the Orion New York and Orion MidWest notes (including outstanding interest) owed to Reliant Energy. After tendering for \$0.2 million of the 12% senior notes, the remaining net cash proceeds of \$248 million were distributed to/invested in Reliant Energy, including the issuance of a \$92 million note. See note 2.

*Assumptions Related to Debt, Deferred Financing Costs and Interest Expense on Discontinued Operations.* Based on Orion Power's obligation to utilize the net proceeds from the sale to prepay debt, Orion Power classified the related debt amounts for the Orion New York and Orion MidWest related party notes and the Orion New York related party revolver (and the related interest expense) as discontinued operations.

Orion Power classified the related deferred financing costs (and associated interest expense) on all of these debt amounts as discontinued operations. Orion Power allocated \$1 million of related third party interest expense during the three months ended March 31, 2006 to discontinued operations. Orion Power allocated \$7 million of related interest expense – affiliates during the three months ended March 31, 2006 to discontinued operations.

**(b) All Discontinued Operations**

The following summarizes certain financial information of the businesses reported as discontinued operations:

	<b>New York Plants</b>
	<b>(in millions)</b>
<b>Three months ended March 31, 2007:</b>	
Revenues.....	\$ (1)
Loss before income tax expense/benefit.....	(1)
<b>Three months ended March 31, 2006:</b>	
Revenues.....	\$ 107
Income before income tax expense/benefit.....	10

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

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
	<b>(in millions)</b>	
<b>Current Assets:</b>		
Accounts receivable, net .....	<u>\$ 3</u>	<u>\$ 2</u>
Total current assets.....	<u>3</u>	<u>2</u>
Total Assets .....	<u>\$ 3</u>	<u>\$ 2</u>
<b>Current Liabilities:</b>		
Other current liabilities.....	<u>\$ 3</u>	<u>3</u>
Total current liabilities .....	<u>3</u>	<u>3</u>
Total Liabilities .....	<u>\$ 3</u>	<u>\$ 3</u>

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following should be read in conjunction with our 2006 annual consolidated financial statements.

**Consolidated Results of Operations**

**Three Months Ended March 31, 2007 Compared to Three Months Ended March 31, 2006**

*Net Loss.* We reported \$5 million consolidated net loss for the three months ended March 31, 2007 compared to \$46 million consolidated net income for the same period in 2006.

	<b>Three Months Ended March 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>Change</b>
	(in millions)		
Gross margin .....	\$ 84	\$ 61	\$ 23
Operation and maintenance (including from affiliates) ..	(52)	(31)	(21)
Taxes other than income taxes.....	(3)	(3)	-
General and administrative – primarily affiliates .....	(7)	(6)	(1)
Gains on sales of assets and emission allowances, net – primarily affiliates .....	3	67	(64)
Depreciation and amortization.....	(21)	(21)	-
Interest expense .....	(9)	(9)	-
Interest expense – affiliates .....	(2)	-	(2)
Interest income – primarily affiliates.....	2	1	1
Income taxes.....	1	(25)	26
Income (loss) from continuing operations .....	(4)	34	(38)
Income (loss) from discontinued operations.....	(1)	12	(13)
Net income (loss).....	<u>\$ (5)</u>	<u>\$ 46</u>	<u>\$ (51)</u>

*Revenues (including from affiliates).*

	<b>Three Months Ended March 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>Change</b>
	(in millions)		
Third-party revenues.....	\$ 8	\$ 4	\$ 4
Revenues – affiliates.....	136	114	22 <sup>(1)</sup>
Total revenues.....	<u>\$ 144</u>	<u>\$ 118</u>	<u>\$ 26</u>

(1) Merchant sales to PJM Interconnection, LLC through Reliant Energy affiliates increased due to higher market prices and increased power sales volumes.

*Fuel and Purchased Power (including from affiliates).*

	<b>Three Months Ended March 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>Change</b>
	(in millions)		
Third-party fuel and purchased power costs.....	\$ 58	\$ 57	\$ 1
Fuel and purchased power – affiliates .....	1	-	1
Unrealized losses .....	1	-	1
Total fuel and purchased power .....	<u>\$ 60</u>	<u>\$ 57</u>	<u>\$ 3</u>

*Gross Margin.*

	Three Months Ended March 31,		
	2007	2006	Change
	(in millions)		
Orion MidWest.....	\$ 85	\$ 61	\$ 24 <sup>(1)</sup>
Net unrealized losses on energy derivatives.....	(1)	-	(1)
Gross margin.....	<u>\$ 84</u>	<u>\$ 61</u>	<u>\$ 23</u>

(1) Increase primarily due to higher unit margins (higher power prices) and higher economic generation due to colder weather. These increases were partially offset by decreased commercial capacity factor due to plant outages.

*Operation and Maintenance (including from affiliates).*

	Change from Three Months Ended March 31, 2006 to 2007 (in millions)
Planned outages.....	\$ 14
Unplanned outages and maintenance spending.....	3
Other, net.....	4
Net increase in expense.....	<u>\$ 21</u>

*Taxes Other than Income Taxes.* Taxes other than income taxes did not change significantly during the three months ended March 31, 2007 compared to the same period in 2006.

*General and Administrative – Primarily Affiliates.* General and administrative – affiliates expenses, which are allocated from Reliant Energy, did not change significantly during the three months ended March 31, 2007 compared to the same period in 2006. See note 2 to our interim financial statements.

*Gains on Sales of Assets and Emission Allowances, Net — Primarily Affiliates.* See note 10 to our interim financial statements.

*Depreciation and Amortization.* Depreciation and amortization expense did not change significantly during the three months ended March 31, 2007 compared to the same period in 2006.

*Interest Expense.* Interest expense (including from affiliates) did not change significantly during the three months ended March 31, 2007 compared to the same period in 2006.

*Interest Income — Primarily Affiliates.* Interest income — primarily affiliates increased \$1 million during the three months ended March 31, 2007 compared to the same period in 2006 primarily due to the \$92 million note receivable from Reliant Energy, which we entered into in March 2006.

*Income Tax Expense (Benefit).* See note 7 to our interim financial statements.

*Income (Loss) from Discontinued Operations.* See note 11 to our interim financial statements.

## Liquidity and Capital Resources

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources” in our 2006 annual consolidated financial statements and related financial information.

### Historical Cash Flows

#### *Cash Flows — Operating Activities*

	Three Months Ended March 31,		
	2007	2006 (in millions)	Change
Operating income .....	\$ 4	\$ 67	\$ (63)
Depreciation and amortization.....	21	21	–
Gains on sales of assets and emission allowances, net .....	(3)	(67)	64
Other, net .....	5	1	4
Net cash provided by continuing operations from operating activities .....	27	22	5
Net cash provided by (used in) discontinued operations from operating activities.....	(1)	12	(13)
Net cash provided by operating activities .....	<u>\$ 26</u>	<u>\$ 34</u>	<u>\$ (8)</u>

#### *Cash Flows — Investing Activities*

	Three Months Ended March 31,		
	2007	2006 (in millions)	Change
Capital expenditures .....	\$ (17)	\$ (9)	\$ (8)
Proceeds from sales of emission allowances – affiliates ..	4	60	(56)
Net cash provided by (used in) continuing operations from investing activities.....	(13)	51	(64)
Net cash provided by discontinued operations from investing activities .....	–	968	(968)
Net cash provided by (used in) investing activities.....	<u>\$ (13)</u>	<u>\$ 1,019</u>	<u>\$ (1,032)</u>

#### *Cash Flows — Financing Activities*

	Three Months Ended March 31,		
	2007	2006 (in millions)	Change
Distributions to Reliant Energy .....	\$ –	\$ (209)	\$ 209
Loan to Reliant Energy .....	–	(92)	92
Payments to Reliant Energy on revolver .....	(12)	–	(12)
Other, net .....	–	(1)	1
Net cash used in continuing operations from financing activities .....	(12)	(302)	290
Net cash used in discontinued operations from financing activities .....	–	(712)	712
Net cash used in financing activities.....	<u>\$ (12)</u>	<u>\$ (1,014)</u>	<u>\$ 1,002</u>

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

#### New Accounting Pronouncements

See note 7 to our interim financial statements.

**Significant Accounting Policies**

See note 2 to our 2006 annual consolidated financial statements.

**Critical Accounting Estimates**

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Accounting Estimates — New Accounting Pronouncements, Significant Accounting Policies and Critical Accounting Estimates — Critical Accounting Estimates” in our 2006 annual consolidated financial statements and related financial information and note 2 to our 2006 annual consolidated financial statements.

**QUANTITATIVE AND QUALITATIVE DISCLOSURES  
ABOUT MARKET RISK**

**Market Risks and Risk Management**

Our primary market risk exposure relates to fluctuations in commodity prices. See “Quantitative and Qualitative Disclosures About Market Risk” in our 2006 annual consolidated financial statements and related financial information.

**Non-Trading Market Risks**

**Commodity Price Risk**

As of March 31, 2007, the fair values of the contracts related to our net non-trading derivative assets and liabilities are:

<u>Source of Fair Value</u>	<u>Twelve Months Ending March 31, 2008</u>	<u>Remainder of 2008</u>	<u>2009</u>	<u>2010 (in millions)</u>	<u>2011</u>	<u>2012 and thereafter</u>	<u>Total fair value</u>
Cash flow hedges <sup>(1)</sup> .....	\$ 3	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3
Total.....	<u>\$ 3</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3</u>

(1) As of March 31, 2007, all previously designated cash flows hedges have been de-designated. See note 5 to our interim financial statements.

A hypothetical 10% movement in the underlying energy prices would have the following potential gain (loss) impacts on our non-trading derivatives:

<u>As of</u>	<u>Market Prices</u>	<u>Fair Value of Cash Flow Hedges</u>	<u>Earnings Impact of Other Derivatives (in millions)</u>	<u>Total Potential Gain (Loss) in Fair Value</u>
March 31, 2007.....	10% decrease	\$ -	\$ (3)	\$ (3)
December 31, 2006.....	10% decrease	-	(3)	(3)

**Interest Rate Risk**

We assess interest rate risks using a sensitivity analysis that measures the potential change in our interest expense based on a hypothetical one percentage point movement in the underlying variable interest rate indices.

If interest rates decreased by one percentage point from their March 31, 2007 and December 31, 2006 levels, the fair market values of our fixed rate debt would have increased by \$12 million and \$13 million, respectively.