

ORION POWER HOLDINGS, INC.

Report of Independent Registered Public Accounting Firm

The Board of Directors
Orion Power Holdings, Inc.:

We have audited the accompanying consolidated balance sheets of Orion Power Holdings, Inc. and subsidiaries (the Company), as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholder's equity and comprehensive income (loss), and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Orion Power Holdings, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in notes 8 and 7 to the consolidated financial statements, the Company changed its accounting for income tax uncertainties in 2007 and defined benefit pension and other postretirement plans in 2006, respectively.

KPMG LLP

Houston, Texas
February 25, 2008

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of Orion Power Holdings, Inc. and Subsidiaries
Houston, Texas

We have audited the accompanying consolidated statements of operations, stockholder's equity and comprehensive loss, and cash flows of Orion Power Holdings, Inc. and subsidiaries (the "Company") for the year ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the results of operations and cash flows of Orion Power Holdings, Inc. and subsidiaries for the year ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

DELOITTE & TOUCHE LLP

Houston, Texas
March 14, 2006

ORION POWER HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	2007	2006	2005
	(thousands of dollars)		
Revenues:			
Revenues.....	\$ 22,317	\$ 22,861	\$ 91,919
Revenues – affiliates.....	542,568	474,851	548,533
Total.....	<u>564,885</u>	<u>497,712</u>	<u>640,452</u>
Expenses:			
Cost of sales.....	227,240	222,358	186,912
Cost of sales – affiliates.....	(5,521)	2,427	68,272
Operation and maintenance.....	161,713	143,786	115,924
Operation and maintenance – affiliates.....	37,696	35,924	43,500
Taxes other than income taxes.....	11,570	13,089	3,709
General and administrative – primarily affiliates.....	27,685	27,980	40,493
Gains on sales of assets and emission allowances, net – primarily affiliates.....	(7,480)	(66,964)	(58,189)
Depreciation and amortization.....	137,602	100,107	126,416
Total operating expenses.....	<u>590,505</u>	<u>478,707</u>	<u>527,037</u>
Operating Income (Loss).....	<u>(25,620)</u>	<u>19,005</u>	<u>113,415</u>
Other Income (Expense):			
Other, net.....	–	–	42
Interest expense.....	(34,314)	(38,472)	(39,949)
Interest expense – affiliates.....	(9,293)	(1,351)	(908)
Interest income – primarily affiliates.....	8,452	8,956	382
Total other expense.....	<u>(35,155)</u>	<u>(30,867)</u>	<u>(40,433)</u>
Income (Loss) from Continuing Operations Before			
Income Taxes	(60,775)	(11,862)	72,982
Income tax expense (benefit).....	(25,737)	(31,135)	24,385
Income (Loss) from Continuing Operations.....	<u>(35,038)</u>	<u>19,273</u>	<u>48,597</u>
Income (loss) from discontinued operations.....	7,124	5,375	(86,096)
Income (Loss) Before Cumulative Effect of			
Accounting Changes	(27,914)	24,648	(37,499)
Cumulative effect of accounting change, net of tax.....	–	–	(198)
Net Income (Loss).....	<u>\$ (27,914)</u>	<u>\$ 24,648</u>	<u>\$ (37,697)</u>

See Notes to the Consolidated Financial Statements

ORION POWER HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2007	2006
	(thousands of dollars, except per share amounts)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 259	\$ 81
Accounts receivable, principally customer, net of allowance of \$0	102	1,664
Receivables from affiliates, net	19,968	33,046
State income taxes receivable	45,763	10,084
Inventory	57,233	50,289
Derivative assets	-	5,086
Accumulated deferred income taxes	6,713	7,359
Collateral posted under agreement with Reliant Energy, Inc.	2,000	3,278
Prepayments and other current assets	1,843	1,304
Current assets of discontinued operations	2,132	2,460
Total current assets	136,013	114,651
Property, Plant and Equipment, net	1,619,651	1,587,885
Other Assets:		
Goodwill, net	173,570	175,520
Other intangibles, net	165,509	183,163
Long-term note receivable from Reliant Energy, Inc.	67,200	92,200
Long-term collateral posted under agreement with Reliant Energy, Inc.	14,392	12,326
Other	9,383	59,615
Total other assets	430,054	522,824
Total Assets	\$ 2,185,718	\$ 2,225,360
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current Liabilities:		
Current portion of long-term debt	\$ 11,409	\$ 10,505
Accounts payable, principally trade	36,278	29,594
Accrued interest payable	7,999	7,996
Other taxes payable	12,496	10,910
Other	17,530	9,335
Current liabilities of discontinued operations	-	3,286
Total current liabilities	85,712	71,626
Other Liabilities:		
Accumulated deferred income taxes	165,709	178,042
Benefit obligations	46,726	58,100
Taxes payable to Reliant Energy, Inc.	66,294	84,310
Long-term liabilities of discontinued operations	3,542	-
Other	10,602	11,043
Total other liabilities	292,873	331,495
Revolving Credit Facility with Reliant Energy, Inc.	37,299	12,683
Long-term Debt	416,934	428,343
Commitments and Contingencies		
Stockholder's Equity:		
Common stock; par value \$1.00 per share (1,000 shares authorized, issued and outstanding) ..	1	1
Additional paid-in capital	2,211,138	2,211,139
Accumulated deficit	(851,607)	(823,693)
Accumulated other comprehensive loss	(6,632)	(6,234)
Total stockholder's equity	1,352,900	1,381,213
Total Liabilities and Stockholder's Equity	\$ 2,185,718	\$ 2,225,360

See Notes to the Consolidated Financial Statements

ORION POWER HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	2007	2006	2005
	(thousands of dollars)		
Cash Flows from Operating Activities:			
Net income (loss).....	\$ (27,914)	\$ 24,648	\$ (37,697)
(Income) loss from discontinued operations.....	(7,124)	(5,375)	86,096
Net income (loss) from continuing operations and cumulative effect of accounting changes.....	(35,038)	19,273	48,399
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Cumulative effect of accounting change.....	-	-	198
Depreciation and amortization.....	137,602	100,107	126,416
Deferred income taxes.....	(21,422)	(27,474)	44,581
Non-cash equity contribution of operation and maintenance and general and administrative costs from Reliant Energy, Inc., net.....	-	-	56,890
Net changes in energy derivatives.....	1,108	(1,108)	4,846
Net amortization of contractual rights and obligations.....	(302)	(2,218)	(8,177)
Amortization of revaluation of acquired debt.....	(10,505)	(9,721)	(8,921)
Gains on sales of assets and emission allowances, net – primarily affiliates.....	(7,480)	(66,964)	(58,189)
Non-cash federal income tax distributions to Reliant Energy, Inc., net.....	-	-	(26,361)
Other, net.....	366	(658)	2,003
Changes in other assets and liabilities:			
Accounts receivable, net.....	1,562	2,415	48,996
Inventory.....	(7,384)	3,414	(1,853)
Other current assets.....	(539)	2,173	(2,603)
Other assets.....	4,867	10,036	422
Accounts payable.....	(27)	5,163	1,644
Payable to/receivable from affiliates, net.....	(14,840)	7,188	(52,412)
Collateral posted under agreement with Reliant Energy, Inc.....	(788)	(15,604)	-
Income taxes payable/receivable.....	22,938	13,510	1,768
Accrued interest.....	3	(4)	-
Long-term taxes payable to Reliant Energy, Inc. and related accrued interest.....	(18,015)	-	-
Other current liabilities.....	184	1,735	(9,881)
Other liabilities.....	(3,680)	3,726	(5,014)
Net cash provided by continuing operations from operating activities.....	48,610	44,989	162,752
Net cash provided by (used in) discontinued operations from operating activities.....	6,726	(49,689)	171,800
Net cash provided by (used in) operating activities.....	55,336	(4,700)	334,552
Cash Flows from Investing Activities:			
Capital expenditures.....	(109,212)	(45,566)	(16,334)
Proceeds from sales of assets, net.....	259	-	2,372
Proceeds from sales of emission allowances.....	624	1,134	8,554
Proceeds from sales of emission allowances – affiliates.....	12,678	69,320	56,519
Purchases of emission allowances – affiliates.....	(9,643)	-	(1,998)
Net cash provided by (used in) continuing operations from investing activities.....	(105,294)	24,888	49,113
Net cash provided by discontinued operations from investing activities.....	520	967,566	79,101
Net cash provided by (used in) investing activities.....	(104,774)	992,454	128,214
Cash Flows from Financing Activities:			
Distributions to Reliant Energy, Inc.....	-	(209,400)	(340,000)
Changes in revolving credit facility with Reliant Energy, Inc., net.....	24,616	12,683	(7,300)
(Loan to) repayments from Reliant Energy, Inc.....	25,000	(92,200)	-
Payments of long-term debt.....	-	(191)	-
Net cash provided by (used in) continuing operations from financing activities.....	49,616	(289,108)	(347,300)
Net cash used in discontinued operations from financing activities.....	-	(712,317)	(110,183)
Net cash provided by (used in) financing activities.....	49,616	(1,001,425)	(457,483)
Net Change in Cash and Cash Equivalents.....	178	(13,671)	5,283
Cash and Cash Equivalents at Beginning of Period.....	81	13,752	8,469
Cash and Cash Equivalents at End of Period.....	\$ 259	\$ 81	\$ 13,752
Supplemental Disclosure of Cash Flow Information:			
Cash Payments:			
Interest paid (net of amounts capitalized) to third parties for continuing operations.....	44,756	\$ 48,360	\$ 48,686
Income taxes paid (net of income tax refunds received) for continuing operations.....	(2,858)	(17,022)	3,917
Non-cash Disclosure:			
Contributions from (distributions to) Reliant Energy, Inc., net for continuing operations.....	-	(39,543)	(51,471)
Contributions from Reliant Energy, Inc., net for discontinued operations.....	-	-	30,468

See Notes to the Consolidated Financial Statements

ORION POWER HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)

	Accumulated Other Comprehensive Income (Loss)											
	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Deferred Derivative Gains (Losses)	Benefits Actuarial Net Gain (Loss)	Benefits Net Prior Service Costs	Additional Minimum Benefits Liability	Total Accumulated Other Comprehensive Income (Loss)	Discontinued Operations Accumulated Other Comprehensive Loss	Total Stockholder's Equity	Comprehensive Income (Loss)
	Shares	Amount										
	(thousands of dollars)											
Balance, December 31, 2004	1,000	\$ 1	\$ 2,821,552	\$ (810,644)	\$ 45,047	\$ —	\$ —	\$ (147)	\$ 44,900	\$ (3,738)	\$ 2,052,071	
Net loss				(37,697)							(37,697)	\$ (37,697)
Distributions to Reliant Energy, Inc., net			(361,001)								(361,001)	
Deferred gain from cash flow hedges, net of tax of \$3 million					4,925				4,925		4,925	4,925
Reclassification of net deferred (gain) loss from cash flow hedges, net of tax of \$22 million and \$2 million					(31,125)				(31,125)	3,403	(27,722)	(31,125)
Other comprehensive income from discontinued operations												3,403
Comprehensive loss												<u>\$ (60,494)</u>
Balance, December 31, 2005	1,000	1	2,460,551	(848,341)	18,847	—	—	(147)	18,700	(335)	1,630,576	
Net income				24,648							24,648	\$ 24,648
Distributions to Reliant Energy, Inc., net			(249,412)								(249,412)	
Changes in minimum pension liability, net of tax of \$1 million								(2,029)	(2,029)		(2,029)	(2,029)
Deferred loss from cash flow hedges, net of tax of \$3 million					(4,334)				(4,334)		(4,334)	(4,334)
Reclassification of net deferred (gain) loss from cash flow hedges, net of tax of \$8 million \$0					(11,802)				(11,802)	335	(11,467)	(11,802)
Other comprehensive income from discontinued operations												335
Adjustment to initially apply FASB Statement No. 158, net of tax of \$4 million, \$2 million and \$1 million						(5,566)	(3,379)	2,176	(6,769)		(6,769)	
Comprehensive income												<u>\$ 6,818</u>
Balance, December 31, 2006	1,000	\$ 1	\$ 2,211,139	\$ (823,693)	\$ 2,711	\$ (5,566)	\$ (3,379)	\$ —	\$ (6,234)	\$ —	\$ 1,381,213	

(continued)

ORION POWER HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)

(continued)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)					Discontinued Operations Accumulated Other Comprehensive Loss	Total Stockholder's Equity	Comprehensive Income (Loss)
					Deferred Derivative Gains (Losses)	Benefits Actuarial Net Gain (Loss)	Benefits Net Prior Service Costs	Additional Minimum Benefits Liability	Total Accumulated Other Comprehensive Income (Loss)			
	Shares	Amount										
	(thousands of dollars)											
Balance, December 31, 2006	1,000	\$ 1	\$ 2,211,139	\$ (823,693)	\$ 2,711	\$ (5,566)	\$ (3,379)	\$ -	\$ (6,234)	\$ -	\$ 1,381,213	
Net loss				(27,914)							(27,914)	\$ (27,914)
Deferred gain from cash flow hedges, net of tax of \$0					330				330		330	330
Reclassification of net deferred gain from cash flow hedges, net of tax of \$2 million					(3,041)				(3,041)		(3,041)	(3,041)
Reclassification of benefits net prior service costs into net loss, net of tax of \$0							401		401		401	401
Reclassification of benefits actuarial net loss into net loss, net of tax of \$0						170			170		170	170
Deferred benefits, net of tax of \$1 million and \$1 million....						1,100	642		1,742		1,742	1,742
Comprehensive loss												\$ (28,312)
Balance, December 31, 2007	<u>1,000</u>	<u>\$ 1</u>	<u>\$ 2,211,139</u>	<u>\$ (851,607)</u>	<u>\$ -</u>	<u>\$ (4,296)</u>	<u>\$ (2,336)</u>	<u>\$ -</u>	<u>\$ (6,632)</u>	<u>\$ -</u>	<u>\$ 1,352,901</u>	

See Notes to the Consolidated Financial Statements

ORION POWER HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Background and Basis of Presentation

Background. “Orion Power Holdings” refers to Orion Power Holdings, Inc., a Delaware corporation. “Orion Power” refers to Orion Power Holdings and its consolidated subsidiaries. “Reliant Energy” refers to Reliant Energy, Inc. and its consolidated subsidiaries. Orion Power owns and operates electric generation facilities in Ohio and Pennsylvania with an aggregate generating capacity of 2,683 megawatts (MW) as of December 31, 2007. Orion Power typically sells its wholesale products to independent system operators, regulated utilities, municipalities, energy supply companies (including Reliant Energy), cooperatives and retail “load” or customer aggregators.

On February 19, 2002, Reliant Energy acquired Orion Power through a merger.

Basis of Presentation. These consolidated statements include all revenues and costs directly attributable to Orion Power including costs for facilities and costs for functions and services performed by Reliant Energy and charged to Orion Power. All significant intercompany transactions have been eliminated.

(2) Summary of Significant Accounting Policies

(a) Use of Estimates and Market Risk and Uncertainties.

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
- disclosure of contingent assets and liabilities at the date of the financial statements.

Orion Power’s critical accounting estimates include: (a) fair value of recorded goodwill, property, plant and equipment and derivative assets and liabilities and (b) deferred tax assets, valuation allowances and tax liabilities. Actual results could differ from the estimates.

Orion Power is subject to various risks inherent in doing business. See notes 2(c), 2(d), 2(e), 2(g), 2(h), 2(n), 2(o), 2(p), 4, 5, 6, 7, 8, 9 and 10.

(b) Principles of Consolidation.

Orion Power Holdings includes its accounts and those of its wholly-owned subsidiaries in the consolidated financial statements.

(c) Power Generation and Capacity Revenues.

Orion Power records gross revenues from the sale of electricity and other energy services under the accrual method. Electric power and other energy services are sold at market-based prices through existing power exchanges, related party affiliates or third party contracts. Energy sales and services that have been delivered but not billed by period-end are estimated.

(d) Derivatives and Hedging Activities.

Orion Power accounts for its derivatives instruments and hedging activities in accordance with SFAS No. 133, “Accounting for Derivatives Instruments and Hedging Activities,” as amended (SFAS No. 133).

For Orion Power’s risk management activities, it uses both derivative and non-derivative contracts that provide for settlement in cash or by delivery of a commodity. The primary types of derivative instruments Orion Power uses

are forwards, futures, swaps and options. Orion Power accounts for its derivatives under one of three accounting methods (mark-to-market, accrual (under the normal purchase/normal sale exception to fair value) or cash flow hedge accounting) based on facts and circumstances. The fair values of derivative activities are determined by (a) prices actively quoted, (b) prices provided by other external sources or (c) prices based on models and other valuation methods.

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

If certain conditions are met, a derivative instrument may be designated as a cash flow hedge. Derivatives designated as cash flow hedges must have a high correlation between price movements in the derivative and the hedged item. The changes in fair value of cash flow hedges are deferred in accumulated other comprehensive income (loss), net of tax, to the extent the contracts are, or have been, effective as hedges, until the forecasted transactions affect earnings. At the time the forecasted transactions affect earnings, Orion Power reclassifies the amounts in accumulated other comprehensive income (loss) into earnings. Orion Power records the ineffective portion of changes in fair value of cash flow hedges immediately into earnings. For all other derivatives, changes in fair value are recorded as unrealized gains or losses in its results of operations.

If and when an acceptable level of correlation no longer exists, hedge accounting ceases and changes in fair value are recognized in its results of operations. If it becomes probable that a forecasted transaction will not occur, Orion Power immediately recognizes the related deferred gains or losses in its results of operations. The associated hedging instrument is then marked to market through its results of operations for the remainder of the contract term unless a new hedging relationship is redesignated.

Realized gains and losses on derivatives contracts not held for trading purposes are reported either on a net or gross basis based on the relevant facts and circumstances. Hedging transactions that do not physically flow are included in the same caption as the items being hedged. A summary of Orion Power's derivative activities and classification in its results of operations is:

Instrument	Purpose for Holding or Issuing Instrument⁽¹⁾	Transactions that Physically Flow	Transactions that Financially Settle⁽²⁾
Power futures, forward, swap and option contracts	Power sales Power purchases	Revenues Cost of sales	Revenues Revenues
Natural gas and fuel futures, forward, swap and option contracts	Natural gas and fuel sales Natural gas and fuel purchases	Revenues Cost of sales	Cost of sales Cost of sales

(1) The purpose for holding or issuing is not impacted by the accounting method elected for each instrument.

(2) Includes classification for mark-to-market derivatives and amounts reclassified from accumulated other comprehensive income (loss) related to cash flow hedges.

In addition to market risk, Orion Power is exposed to credit and operational risk. Reliant Energy has a risk control framework, to which Orion Power is subject, to manage these risks, which include: (a) measuring and monitoring these risks, (b) review and approval of new transactions relative to these risks, (c) transaction validation and (d) portfolio valuation and reporting. Orion Power uses mark-to-market valuation, value-at-risk and other metrics in monitoring and measuring risk. Reliant Energy's risk control framework includes a variety of separate but complementary processes, which involve commercial and senior management and Reliant Energy's Board of Directors. See note 2(e) for further discussion of Orion Power's credit policy.

Effective September 1, 2006, Orion Power de-designated its cash flow hedges of coal contracts and either began utilizing the mark-to-market method of accounting or elected the normal purchase/normal sale exception. During the third quarter of 2006, Orion Power de-designated its remaining cash flows hedges; therefore, as of December 31, 2007 and 2006, Orion Power has no cash flow hedges.

Set-off of Derivative Assets and Liabilities. Where derivative instruments are subject to a master netting agreement and the accounting criteria to offset are met, Orion Power presents its derivative assets and liabilities on a net basis. Derivative assets/liabilities and accounts receivable/payable are presented and set-off separately in the

consolidated balance sheets although in most cases contracts permit the set-off of derivative assets/liabilities and accounts receivable/payable with a given counterparty. However, Orion Power does not offset collateral (net margin deposits) related to these derivatives.

New Accounting Pronouncement Not Yet Adopted — Offsetting of Amounts. The FASB issued FSP FIN 39-1, an amendment of FASB Interpretation No. 39 (FIN 39), which was applicable for Orion Power beginning January 1, 2008. This interpretation allows either (a) offsetting assets and liabilities for derivative instruments under a common master netting arrangement only if the fair value amounts recognized for any related cash collateral are also offset or (b) presenting these amounts gross.

Effective January 1, 2008, Orion Power plans to discontinue netting its derivative assets and liabilities and present them on a gross basis. Cash collateral amounts will remain presented on a gross basis. Orion Power's December 31, 2007 consolidated balance sheet will not be affected because all derivative contracts accounted for under the mark-to-market and cash flow hedge accounting methods have settled over the contract terms.

(e) Credit Risk.

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

Orion Power's credit exposure is based on its derivative assets and accounts receivable from counterparties, after taking into consideration netting within each contract and any master netting contracts with counterparties. Orion Power provides reserves for non-investment grade counterparties representing a significant portion of its credit exposure. As of December 31, 2007, Orion Power has no credit exposure. As of December 31, 2006, one non-investment grade counterparty represented 100% (\$4 million) of Orion Power's credit exposure. As of December 31, 2007 and 2006, Orion Power held no collateral from these counterparties. There were no other counterparties representing greater than 10% of Orion Power's credit exposure.

(f) General and Administrative Expenses — Primarily Affiliates.

General and administrative expenses from affiliates include, among other items, (a) selling and marketing, (b) bad debt expense, (c) financial services, (d) legal costs, (e) regulatory costs and (f) certain benefit costs. See note 3.

(g) Property, Plant and Equipment and Depreciation Expense.

Orion Power computes depreciation using the straight-line method based on estimated useful lives. Depreciation expense was \$87 million, \$76 million and \$95 million during 2007, 2006 and 2005, respectively.

	Estimated Useful Lives (Years)	December 31,	
		2007	2006
(in millions)			
Electric generation facilities	20 – 32	\$ 1,823	\$ 1,783
Land improvements	20 – 32	98	97
Other	3 – 10	10	9
Land		12	12
Assets under construction		89	28
Total		2,032	1,929
Accumulated depreciation		(412)	(341)
Property, plant and equipment, net		\$ 1,620	\$ 1,588

Orion Power periodically evaluates property, plant and equipment for impairment when events or circumstances indicate that the carrying value of these assets may not be recoverable. The evaluation is highly dependent on the

underlying assumptions of related cash flows. Orion Power recorded no material property, plant and equipment impairments during 2007, 2006 and 2005.

In the future, Orion Power could recognize impairments if its wholesale energy market outlook changes negatively. In addition, Orion Power's ongoing evaluation of its business could result in decisions to mothball, retire or dispose of additional generation assets, any of which could result in impairment charges.

(h) Intangible Assets and Amortization Expense.

Goodwill. Orion Power performs its goodwill impairment test annually on April 1 and when events or changes in circumstances indicate that the carrying value may not be recoverable.

Other Intangibles. Orion Power recognizes specifically identifiable intangible assets, including emission allowances and contractual rights, when specific rights and contracts are acquired. Orion Power has no intangible assets with indefinite lives recorded as of December 31, 2007 and 2006.

(i) Capitalization of Interest Expense.

During 2007, 2006 and 2005, Orion power capitalized \$3 million, \$0 and \$0 of interest expense, respectively.

(j) Income Taxes.

Federal. Orion Power is included in the consolidated federal income tax returns of Reliant Energy and calculates its income tax provision on a separate return basis, whereby Reliant Energy pays all federal income taxes on Orion Power's behalf and is entitled to any related tax savings. The difference between Orion Power's current federal income tax expense or benefit, as calculated on a separate return basis, and related amounts paid to/received from Reliant Energy, if any, were recorded in Orion Power's financial statements as adjustments to additional paid-in capital. Reliant Energy changed its funding policy in late December 2006 and these differences are recorded to (a) income taxes payable to Reliant Energy, Inc. if Orion Power has cumulative taxable income on a separate return basis or (b) deferred tax assets if Orion Power has cumulative taxable losses on a separate return basis. Deferred federal income taxes reflected on Orion Power's consolidated balance sheet will ultimately be settled with Reliant Energy. See notes 3 and 8.

State. Orion Power is included in the consolidated state income tax returns of Reliant Energy. It calculates its state provision, related payables or receivables and deferred state income taxes on a separate return basis and settles the related assets and liabilities directly with the governmental entity. See note 8.

(k) Cash and Cash Equivalents.

Orion Power records all highly liquid short-term investments with maturities of three months or less as cash equivalents.

(l) Allowance for Doubtful Accounts.

Orion Power accrues an allowance for doubtful accounts based on estimates of uncollectible revenues by analyzing counterparty credit ratings, historical collections, accounts receivable agings and other factors. Orion Power writes-off accounts receivable balances against the allowance for doubtful accounts when it determines a receivable is uncollectible.

(m) Inventory.

Orion Power values fuel inventories at the lower of average cost or market. Orion Power removes these inventories as they are used in the production of electricity or sold. Orion Power values materials and supplies at average cost. Orion Power removes these inventories when they are used for repairs, maintenance or capital projects. Sales of fuel inventory are classified as operating activities in the consolidated statement of cash flows.

	December 31,	
	2007	2006
	(in millions)	
Materials and supplies, including spare parts	\$ 21	\$ 19
Coal	34	30
Heating oil	2	1
Total inventory	<u>\$ 57</u>	<u>\$ 50</u>

(n) Environmental Costs.

Orion Power expenses environmental expenditures related to existing conditions that do not have future economic benefit. Orion Power capitalizes environmental expenditures for which there is a future economic benefit. Orion Power records liabilities for expected future costs, on an undiscounted basis, related to environmental assessments and/or remediation when they are probable and can be reasonably estimated. See note 10.

(o) Asset Retirement Obligations.

Orion Power's asset retirement obligations relate to future costs associated primarily with ash disposal site closures. Orion Power's asset retirement obligations are \$8 million and \$4 million as of December 31, 2007 and 2006, respectively. As of December 31, 2007 and 2006, Orion Power has \$3 million (classified in other long-term assets) on deposit with the state of Pennsylvania to guarantee its obligation related to future closures of ash disposal sites. See note 10.

During 2005, Orion Power adopted an accounting interpretation relating to asset retirement obligations. This interpretation clarifies that an asset retirement obligation is unconditional even though uncertainty exists about the timing and/or method of settlement and requires that a liability be recognized if it can be reasonably estimated. Based on this, Orion Power (a) recorded a cumulative effect of an accounting change, net of tax, of \$198,000, (b) increased other long-term liabilities by \$624,000, (c) increased property, plant and equipment by \$317,000 and (d) decreased deferred income tax liabilities by \$109,000.

(p) Repair and Maintenance Costs for Power Generation Assets.

Orion Power recognizes repair and maintenance costs as incurred.

(q) New Accounting Pronouncement Not Yet Adopted — Fair Value.

The FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," (SFAS No. 157), which defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. SFAS No. 157 is to be applied prospectively, except for aspects that do not apply to Orion Power. Orion Power adopted SFAS No. 157 on January 1, 2008. In connection with the adoption, no cumulative effect of an accounting change will be recognized. For non-financial assets and liabilities, the adoption of SFAS No. 157 has been deferred until January 1, 2009.

(3) 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 and Technical 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. During 2005, Orion Power only paid a certain amount for these services. Beginning January 2006, Orion Power began paying all of the costs for these services.

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

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(in millions)		
Allocated or charged by Reliant Energy.....	\$ 65	\$ 64	\$ 84
Unpaid allocations and charges recorded as non-cash equity contributions from Reliant Energy.....	–	–	57

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

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(in millions)		
Sales to Reliant Energy under various commodity agreements ⁽¹⁾	\$ 543	\$ 475	\$ 548
Purchases from Reliant Energy under various commodity agreements ⁽²⁾	1	7	68
Gains on coal sales to Reliant Energy ⁽³⁾	6	5	6
Sales of emission allowances to Reliant Energy ⁽⁴⁾	13	69	56
Gains on emission allowances sales to Reliant Energy ⁽⁵⁾	6	66	53

(1) Recorded in revenues – affiliates.

(2) Recorded in cost of sales – affiliates. Amounts include purchases from an affiliate to meet requirements of contractual commitments.

(3) Recorded in cost of sales – affiliates.

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

(5) Recorded in gains on sales of assets and emission allowances, net.

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 13. 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 2008; however, Reliant Energy plans to extend the maturity each December for 12 months from that date. Orion Power has incurred interest expense (in continuing operations) related to these notes and revolving credit facilities of \$3 million, \$1 million and \$1 million during 2007, 2006 and 2005, respectively.

In March 2006, Orion Power made a term loan to Reliant Energy for \$92 million, which matures in 2010. The note bore interest at ten percent through September 30, 2007 and interest is payable monthly. Effective October 1, 2007, the interest rate was changed to 7.5 percent. During 2007, Reliant energy paid down \$25 million on this loan. Orion Power has earned interest income related to this term loan of \$8 million and \$7 million during 2007 and 2006, respectively.

Secured Revolving Letter of Credit Facility Agreement with Reliant Energy. Reliant Energy posts letters of credit on behalf of Orion Power. As of December 31, 2007 and 2006, Reliant Energy posted letters of credit totaling \$16 million 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 December 31, 2007 and 2006, Orion Power has provided cash collateral of \$16 million to Reliant Energy. During 2007 and 2006, the letters of credit costs, recorded in interest expense, were insignificant and the related interest income was \$1 million.

Cash Distributions to Reliant Energy.

	<u>2007</u>	<u>2006</u>	<u>2005</u>
		(in millions)	
Orion Power Holdings cash distributions to Reliant Energy	\$ —	\$ (209)	\$ (340)

Income Taxes. See discussion in note 2(k) regarding Orion Power's policy with respect to income taxes and the long-term taxes payable to Reliant Energy, Inc.

	<u>2007</u>	<u>2006</u>	<u>2005</u>
		(in millions)	
Non-cash contributions from (distributions to) Reliant Energy related to federal income taxes for continuing and discontinued operations.....	\$ —	\$ (40)	\$ (78)

As of December 31, 2007 and 2006, Orion Power has \$66 million and \$84 million, respectively, recorded as long-term taxes payable to Reliant Energy, Inc., which includes accrued interest payable of \$6 million and \$0, respectively. Orion Power has incurred interest expense related to this payable of \$6 million during 2007.

(4) Intangible Assets

(a) Goodwill.

The following table shows goodwill and the changes (in millions):

As of January 1, 2006.....	\$ 181
Changes	(5)
As of December 31, 2006.....	<u>176</u>
Changes	(2)
As of December 31, 2007.....	<u>\$ 174</u>

As of December 31, 2007 and 2006, Orion Power had \$35 million and \$39 million, respectively, of goodwill that is deductible for United States income tax purposes in future periods.

Goodwill Impairment Tests. Orion Power performed impairment tests at the following dates: April 2005, August 2005, September 2005, April 2006 and April 2007 due to either asset sales or annual impairment tests. No impairments were indicated in these tests.

Estimation of Fair Value. Orion Power estimates the fair value based on a number of subjective factors, including: (a) appropriate weighting of valuation approaches (income approach, market approach and comparable public company approach), (b) projections about future power generation margins, (c) estimates of future cost structure, (d) environmental assumptions, (e) discount rates for estimated cash flows, (f) selection of peer group

companies for the public company approach, (g) required level of working capital, (h) assumed EBITDA multiple for terminal values and (i) time horizon of cash flow forecasts.

In determining the fair value, Orion Power made the following key assumptions: (a) the markets in which Orion Power operates will continue to be deregulated; (b) there will be a recovery in electricity margins over time such that companies building new generation facilities can earn a reasonable rate of return on their investment and (c) the long-term returns on future construction of new generation facilities will likely be driven by integrated utilities, which Orion Power expects will have a lower cost of capital than merchant generators. As part of the process, Orion Power modeled all of its power generation facilities and those of others in the regions in which Orion Power operates. The assumptions for each of the goodwill impairment tests during 2005, 2006 and 2007 were:

Number of years used in internal cash flow analysis.....	15	
EBITDA ⁽¹⁾ multiple for terminal values (2005 tests).....	7.5	
EBITDA multiple for terminal values (April 2006 test).....	7.0	(2)
EBITDA multiple for terminal values (April 2007 test).....	8.0	(2)
Risk-adjusted discount rate for estimated cash flows (2005 tests)	9.0%	
Risk-adjusted discount rate for estimated cash flows (April 2006 test).....	9.5%	(3)
Risk-adjusted discount rate for estimated cash flows (April 2007 test).....	10.0%	(3)
Approximate average anticipated growth rate for demand in power	2.0%	
Long-term after-tax return on investment for new investment	7.5%	

(1) Defined as earnings (loss) before interest expense, interest income, income taxes, depreciation and amortization expenses.

(2) Changed primarily due to market factors affecting peer company comparisons.

(3) Changed primarily due to capital structure of peer company comparisons.

(b) Other Intangibles.

	Remaining Weighted Average Amortization Period (Years)	December 31,			
		2007		2006	
		Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
(in millions)					
SO ₂ emission allowances ⁽¹⁾⁽²⁾	— ⁽¹⁾	\$ 160	\$ (103)	\$ 134	\$ (72)
NO _x emission allowances ⁽¹⁾⁽³⁾	— ⁽¹⁾	180	(71)	181	(60)
Contractual rights ⁽⁴⁾	—	—	—	4	(4)
Total.....		<u>\$ 340</u>	<u>\$ (174)</u>	<u>\$ 319</u>	<u>\$ (136)</u>

(1) SO₂ is sulfur dioxide and NO_x is nitrogen oxides. Amortized to amortization expense on a units-of-production basis. As of December 31, 2007, Orion Power has recorded (a) SO₂ emission allowances through the 2039 vintage year (most of which relate to 2010 and beyond) and (b) NO_x emission allowances through the 2039 vintage year (most of which relate to 2009 and beyond).

(2) During 2007, 2006 and 2005, Orion Power purchased \$28 million, \$0 and \$0, respectively, of SO₂ emission allowances from affiliates.

(3) During 2007, 2006 and 2005, Orion Power purchased \$4 million, \$0 and \$2 million, respectively, of NO_x emission allowances from affiliates.

(4) Amortized to revenues and cost of sales, as applicable, based on the estimated realization of the fair value established on the acquisition date over the contractual lives. As of December 31, 2007, Orion Power has no contractual rights recorded on its consolidated balance sheet.

Amortization expense consists of:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(in millions)		
Emission allowances.....	\$ 50	\$ 25	\$ 31
Contractual rights ⁽¹⁾	\$ -	\$ (1)	\$ (1)
Contractual obligations ⁽¹⁾⁽²⁾	-	3	9
Net.....	\$ -	\$ 2	\$ 8

(1) Amortized to revenues and cost of sales, as applicable, based on the estimated realization of the fair value established on the acquisition date over the contractual lives.

(2) Contractual obligations are in other long-term liabilities.

Estimated amortization expense based on Orion Power's intangibles as of December 31, 2007 for the next five years is (in millions):

2008.....	\$ 1	(1)
2009.....	6	(1)
2010.....	7	(1)
2011.....	7	(1)
2012.....	7	(1)

(1) These amounts do not include expected amortization expense of emission allowances, which have not been purchased as of December 31, 2007.

(5) Derivatives and Hedging Activities

Orion Power uses derivative instruments to manage operational or market constraints and to increase return on its generation assets. The instruments used are fixed-price derivative contracts to hedge the variability in future cash flows from forecasted sales of power and purchases of fuel and power. Orion Power's objective in entering into these fixed-price derivatives is to fix the price for a portion of these transactions. See note 2(d).

During 2006 and 2005, 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 2006 and 2005, \$0 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.

As of December 31, 2007, all derivative instruments accounted for under the mark-to-market and cash flow hedge accounting methods have settled over the contract terms and there are no deferred derivative gains/losses remaining in accumulated other comprehensive loss.

(6) Debt

Outstanding debt to third parties:

	December 31,					
	2007			2006		
	Weighted Average Stated Interest Rate ⁽¹⁾	Long-term	Current	Weighted Average Stated Interest Rate ⁽¹⁾	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 ⁽²⁾		17	11		29	10
Total debt.....		<u>\$ 417</u>	<u>\$ 11</u>		<u>\$ 429</u>	<u>\$ 10</u>

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

(2) Debt acquired by Reliant Energy in the Orion Power acquisition was adjusted to fair market value as of the acquisition date. Included in interest expense is amortization of \$11 million, \$9 million and \$9 million for valuation adjustments for debt for 2007, 2006 and 2005, respectively.

Debt maturities as of December 31, 2007 are (in millions):

2008	\$ -
2009	-
2010	400
2011	-
2012	-
2013 and thereafter	-
	<u>\$ 400</u>

Orion Power Holdings Senior Notes. These notes were recorded at a fair value of \$479 million upon the acquisition by Reliant Energy. The \$79 million premium is being amortized to interest expense over the life of the notes. The senior notes are senior unsecured obligations of Orion Power Holdings, are not guaranteed by any of Orion Power Holdings’ subsidiaries and are non-recourse to Reliant Energy. The senior notes have covenants that restrict the ability of Orion Power Holdings and its subsidiaries to, among other actions, (a) pay dividends or pay subordinated debt, (b) incur indebtedness or issue preferred stock, (c) make investments, (d) divest assets, (e) encumber its assets, (f) enter into transactions with affiliates, (g) engage in unrelated businesses and (h) engage in sale and leaseback transactions. As of December 31, 2007, conditions under these covenants were not met that allow the payment of dividends by Orion Power Holdings. As of December 31, 2007, the adjusted net assets of Orion Power that are restricted to Reliant Energy, Inc. are \$1.3 billion.

See note 3 for debt transactions with affiliates.

(7) Benefit Plans

(a) Pension and Postretirement Benefits.

Benefit Plans. Some Orion Power employees participate in a defined benefit pension plan. Orion Power provides subsidized postretirement benefits to some bargaining employees but generally does not provide them to non-bargaining employees.

Effective December 31, 2006, Orion Power adopted Statement of Financial Accounting Standards No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans.” This statement requires recognition of the funded status of plans, measured as of year end. Orion Power already uses the required measurement date. The adoption did not have a material effect on any individual line item of Orion Power’s consolidated balance sheet as of December 31, 2006. As of December 31, 2007, \$0.1 million and \$0.4 million of net

loss and net prior service costs, respectively, in accumulated other comprehensive loss are expected to be recognized in net periodic benefit cost during the next 12 months.

The benefit obligations and funded status are:

	Pension		Postretirement Benefits	
	2007	2006	2007	2006
	(in millions)			
Change in Benefit Obligation				
Beginning of year	\$ 57	\$ 52	\$ 31	\$ 28
Service cost.....	2	3	1	—
Interest cost.....	3	3	2	2
Benefits paid.....	(2)	(1)	—	—
Actuarial loss.....	—	—	(1)	1
End of year.....	<u>\$ 60</u>	<u>\$ 57</u>	<u>\$ 33</u>	<u>\$ 31</u>
Change in Plan Assets				
Beginning of year	\$ 36	\$ 30	\$ —	\$ —
Employer contributions	9	3	—	—
Benefits paid.....	(2)	(1)	—	—
Actual investment return	3	4	—	—
End of year.....	<u>\$ 46</u>	<u>\$ 36</u>	<u>\$ —</u>	<u>\$ —</u>
Funded Status	<u>\$ (14)</u>	<u>\$ (21)</u>	<u>\$ (33)</u>	<u>\$ (31)</u>

Amounts recognized in the consolidated balance sheets are:

	Pension		Postretirement Benefits	
	December 31,		December 31,	
	2007	2006	2007	2006
	(in millions)			
Current liabilities.....	\$ —	\$ —	\$ (1)	\$ (1)
Noncurrent liabilities.....	(14)	(21)	(32)	(30)
Net amount recognized.....	<u>\$ (14)</u>	<u>\$ (21)</u>	<u>\$ (33)</u>	<u>\$ (31)</u>

The accumulated benefit obligation for all pension plans was \$54 million and \$51 million as of December 31, 2007 and 2006, respectively. All pension plans have accumulated benefit obligations in excess of plan assets.

Net benefit costs are:

	Pension			Postretirement Benefits		
	2007	2006	2005	2007	2006	2005
	(in millions)					
Service cost	\$ 3	\$ 3	\$ 2	\$ —	\$ —	\$ 1
Interest cost	3	3	2	2	2	1
Expected return on plan assets.....	(3)	(2)	(1)	—	—	—
Net amortization.....	1	1	1	—	—	—
Net benefit cost.....	<u>\$ 4</u>	<u>\$ 5</u>	<u>\$ 4</u>	<u>\$ 2</u>	<u>\$ 2</u>	<u>\$ 2</u>

Assumptions. The significant weighted average assumptions used to determine the benefit obligations are:

	Pension		Postretirement Benefits	
	December 31,		December 31,	
	2007	2006	2007	2006
Discount rate.....	5.75%	5.75%	5.75%	5.75%
Rate of compensation increase	3.0%	3.0%	3.0%	3.0%

The significant weighted average assumptions used to determine the net benefit costs are:

	Pension			Postretirement Benefits		
	2007	2006	2005	2007	2006	2005
	Discount rate.....	5.75%	5.75%	5.75%	5.75%	5.75%
Rate of compensation increase	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Expected long-term rate of return on assets.....	7.5%	7.5%	7.5%	N/A	N/A	N/A

As of December 31, 2007 and 2006, Orion Power developed its expected long-term rate of return on pension plan assets based on third party models. These models consider expected inflation, current dividend yields, expected corporate earnings growth and risk premiums based on the expected volatility of each asset category. Orion Power weights the expected long-term rates of return for each asset category to determine its overall expected long-term rate of return on pension plan assets. In addition, Orion Power reviews peer data and historical returns.

Orion Power's assumed health care cost trend rates used to measure the expected cost of benefits covered by its postretirement plan are:

	2007	2006	2005
Health care cost trend rate assumed for next year	8.3%	9.0%	9.0%
Rate to which the cost trend rate is assumed to gradually decline (ultimate trend rate).....	5.5%	5.5%	5.5%
Year that the rate reaches the ultimate trend rate.....	2015	2015	2011

Assumed health care cost trend rates can have a significant effect on the amounts reported for Orion Power's health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects as of December 31, 2007:

	One-Percentage Point	
	Increase	Decrease
	(in millions)	
Effect on service and interest cost	\$ —	\$ —
Effect on accumulated postretirement benefit obligation	5	(4)

Plan Assets. Orion Power's pension weighted average asset allocations and target allocation by asset category are:

	Percentage of Plan Assets as of December 31,		Target Allocation
	2007	2006	2008
Domestic equity securities.....	49%	50%	50%
International equity securities.....	10	11	10
Global equity securities.....	10	11	10
Debt securities.....	31	28	30
Total.....	100%	100%	100%

In managing the investments associated with the pension plans, Orion Power's objective is to exceed, on a net-of-fee basis, the rate of return of a performance benchmark composed of the following indices:

Asset Class	Index	Weight
Domestic equity securities.....	Wilshire 5000 Index	50%
International equity securities.....	MSCI All Country World Ex-U.S. Index	10
Global equity securities.....	MSCI All Country World Index	10
Debt securities.....	Lehman Brothers Aggregate Bond Index	30
Total.....		100%

As a secondary measure, Orion Power compares asset performance to the returns of a universe of comparable funds, where applicable, over a full market cycle. Reliant Energy's Benefits Committee reviews plan asset performance each quarter by comparing the actual quarterly returns of each asset class to its related benchmark. Orion Power's plan assets have generally performed in accordance with the benchmarks.

Cash Obligations. Orion Power does not expect to make pension cash contributions during 2008. Expected benefit payments for the next ten years, which reflect future service as appropriate, are:

	Pension	Postretirement Benefits
	(in millions)	
2008.....	\$ 2	\$ 1
2009.....	2	1
2010.....	2	1
2011.....	3	2
2012.....	3	2
2013-2017.....	24	12

(b) Savings Plan.

Orion Power's employees participate in Reliant Energy's employee savings plans under Sections 401(a) and 401(k) of the Internal Revenue Code. Orion Power's savings plan benefit expense, including matching and discretionary contributions, was \$2 million, \$1 million and \$1 million during 2007, 2006 and 2005, respectively.

(c) Other Employee Matters.

As of December 31, 2007, approximately 74% of Orion Power's employees are subject to collective bargaining arrangements. Collective bargaining arrangements covering 35% of these employees will expire in 2008.

(8) Income Taxes**(a) Summary.**

Orion Power's income tax expense (benefit) is:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(in millions)		
Current:			
Federal	\$ —	\$ —	\$ (26)
State	(4)	(4)	6
Total current	<u>(4)</u>	<u>(4)</u>	<u>(20)</u>
Deferred:			
Federal	(18)	11	57
State	(4)	(38)	(13)
Total deferred	<u>(22)</u>	<u>(27)</u>	<u>44</u>
Income tax expense (benefit) from continuing operations	<u>\$ (26)</u>	<u>\$ (31)</u>	<u>\$ 24</u>
Income tax expense (benefit) from discontinued operations	<u>\$ —</u>	<u>\$ (1)</u>	<u>\$ 6</u>

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

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Federal statutory rate	(35)%	35%	35%
Additions (reductions) resulting from:			
State income taxes, net of federal income taxes	(9)	254 ⁽¹⁾	(6)
Other, net	2	(27)	4
Effective rate	<u>(42)%</u>	<u>262%</u>	<u>33%</u>

(1) Of this percentage, (a) \$17 million (145%) relates to Pennsylvania state law changes, which effectively decreased our limitations to use net operating losses in that state and (b) \$7 million (61%) relates to changes in valuation allowances.

	December 31,	
	2007	2006
	(in millions)	
Deferred tax assets:		
Current:		
Employee benefits	\$ 1	\$ 1
Other	4	6
Total current deferred tax assets	5	7
Non-current:		
Employee benefits	18	21
Net operating loss carryforwards	29	29
Other	13	14
Valuation allowance	(3)	(5)
Total non-current deferred tax assets	57	59
Total deferred tax assets	\$ 62	\$ 66
Deferred tax liabilities:		
Non-current:		
Depreciation and amortization	\$ 215	\$ 209
Other	-	7
Total non-current deferred tax liabilities	215	216
Total deferred tax liabilities	\$ 215	\$ 216
Accumulated deferred income taxes, net	\$ (153)	\$ (150)

(b) Tax Attribute Carryovers.

	December 31, 2007 (in millions)	Statutory Carryforward Period (in years)	Expiration Year(s)
Net Operating Loss Carryforwards:			
State	\$ 480	20	2020 through 2027

(c) Valuation Allowances.

Orion Power assesses its future ability to use federal and state net operating loss carryforwards, capital loss carryforwards and other deferred tax assets using the more-likely-than-not criteria. These assessments include an evaluation of Orion Power's recent history of earnings and losses, future reversals of temporary differences and identification of other sources of future taxable income, including the identification of tax planning strategies in certain situations.

Orion Power's valuation allowances for deferred tax assets are:

	<u>State</u> <u>(in millions)</u>
As of January 1, 2005	\$ 25
Changes in valuation allowance	(1)
As of December 31, 2005	<u>24</u>
Changes in valuation allowance	(19)
As of December 31, 2006	<u>5</u>
Changes in valuation allowance	(2)
As of December 31, 2007	<u>\$ 3</u>

(d) 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 Reliant Eenergy's federal and Orion Power's state tax returns should be recorded in its financial statements. Pursuant to FIN 48, Orion Power may only recognize the tax benefit for financial reporting purposes from an uncertain tax position when it is more-likely-than-not that, based on the technical merits, the position will be sustained by taxing authorities or the courts. The recognized tax benefits are measured as the largest benefit having a greater than fifty percent likelihood of being realized upon settlement with a taxing authority. FIN 48 also provides guidance for derecognition, classification, interest and penalties, disclosures, transition rules 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:

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

Orion Power has the following in its consolidated balance sheet:

	<u>January 1, 2007</u> <u>(immediately after adoption)</u> <u>(in millions)</u>	<u>December 31, 2007</u>
Unrecognized tax benefits ⁽¹⁾	\$ —	\$ — ⁽²⁾
Interest and penalties ⁽¹⁾	—	—

(1) The activity during 2007 was insignificant.

(2) Of this amount, \$0, if recognized, would affect the effective tax rate.

During 2007, 2006 and 2005, Orion Power recognized an insignificant amount of income tax expense (benefit) due to changes in interest and penalties for federal and state income taxes.

Orion Power has the following years that remain subject to examination or are currently under audit for its major tax jurisdictions:

	<u>Subject to Examination</u>	<u>Currently Under Audit</u>
Federal	1997 to 2007	1997 to 2005
Pennsylvania.....	2004 to 2007	2006
New York state and city	2003 to 2006	2003 to 2006

Orion Power, through Reliant Energy, expects to continue discussions with taxing authorities regarding tax positions related to the following, and believe it is reasonably possible some of these matters could be resolved during 2008; however, Orion Power cannot estimate the range of changes that might occur: the timing of tax deductions could be changed as a result of negotiations with respect to depreciation and emission allowances.

(9) Commitments

(a) Lease Commitments.

Operating Lease Expense. Total lease expense for all operating leases was \$2 million, \$2 million and \$1 million during 2007, 2006 and 2005, respectively.

(b) Guarantees and Indemnifications.

Equity Pledged as Collateral for 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 \$1.2 billion as of December 31, 2007.

Interests Pledged as Collateral to Reliant Energy. In connection with Orion Power's debt to Reliant Energy (as discussed in note 3), 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 agreements until an event triggering payment occurs. Orion Power does not expect to make any material payments under these agreements.

(c) Other Commitments.

Property, Plant and Equipment Commitments. As of December 31, 2007, Orion Power has contractual commitments to spend approximately \$203 million on plant and equipment relating primarily to SO₂ emissions reductions.

(10) 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 pre-construction permitting requirements of the Clean Air Act known as "New Source Review." 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. Orion Power recorded the estimated discounted costs associated with these environmental liabilities as part of its asset retirement obligations. See note 2(o).

(11) Estimated Fair Value of Financial Instruments

The fair values of cash and cash equivalents, accounts receivable and payable and derivative assets and liabilities approximate their carrying amounts. Values of Orion Power's debt (see note 6) are:

	December 31,			
	2007		2006	
	Carrying Value	Fair Value ⁽¹⁾	Carrying Value	Fair Value ⁽¹⁾
	(in millions)			
Fixed rate debt	\$ 428	\$ 436	\$ 439	\$ 456
Total debt.....	<u>\$ 428</u>	<u>\$ 436</u>	<u>\$ 439</u>	<u>\$ 456</u>

(1) Orion Power based the fair values of its fixed rate debt on information from market participants.

(12) Sales of Assets and Emission Allowances

Emission Allowances. Orion Power sold emission allowances during 2007, 2006 and 2005 for gains of \$7 million, \$67 million and \$56 million, respectively.

(13) 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 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 3.

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 2006 and 2005 to discontinued operations. Orion Power allocated \$7 million and \$53 million of related interest expense – affiliates during 2006 and 2005, respectively, to discontinued operations. No interest was allocated to discontinued operations subsequent to the closing.

(b) Ceredo Plant.

In 2005, Orion Power sold its 505 MW Ceredo power plant for \$100 million. Orion Power used the net cash proceeds of \$100 million to pay down the Orion MidWest term notes owed to Reliant Energy. During the third quarter of 2005, Orion Power began to report results of Ceredo's operations as discontinued operations effective January 1, 2005.

(c) All Discontinued Operations.

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

	<u>New York Plants</u>		<u>Ceredo Plant</u>		<u>Total</u>
2006					
Revenues.....	\$ 104		\$ —		\$ 104
Income before income tax expense/benefit.....	4	(1)	—		4
2005					
Revenues.....	\$ 1,014		\$ —		\$ 1,014
Loss before income tax expense/benefit.....	(48)	(2)	(32)	(3)	(80)

(1) Includes an additional pre-tax loss on disposal of \$16 million during 2006 primarily due to changes in derivative assets not terminated as of the date of sale. The cumulative pre-tax loss on disposal through December 31, 2006 is \$308 million.

(2) Includes \$292 million estimated loss on disposal.

(3) Includes \$32 million loss on disposal.

Subsequent to the sale of the New York plants in February 2006, Orion Power continues to have (a) insignificant settlements with the independent system operator and (b) property tax settlements. Orion Power recognized \$7 million of income before income taxes from discontinued operations during 2007. These amounts are classified as discontinued operations in the results of operations. In addition, Orion Power has some amounts on its consolidated balance sheets classified as discontinued operations relating to these settlements and other insignificant items.