

ORION POWER HOLDINGS, INC. AND SUBSIDIARIES

As of December 31, 2008 and 2007 and For the Three Years Ended December 31, 2008

- Forward-Looking Statement
- Financial Statements
- Management's Discussion and Analysis of Financial Condition and Results of Operations
- Quantitative and Qualitative Disclosures About Market Risk
- Unaudited Quarterly Information
- Ratio of Earnings from Continuing Operations to Fixed Charges

“Orion Power” refers to Orion Power Holdings, Inc. and its consolidated subsidiaries and “we,” “us” and “our” refer to Orion Power, unless we specify or the context indicates otherwise. “Reliant Energy” refers to Reliant Energy, Inc. and its consolidated subsidiaries, unless we specify or the context indicates otherwise. We are a wholly-owned subsidiary of Reliant Energy. All other terms not defined herein are defined in the notes to our consolidated financial statements.

Forward-Looking Statement

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,” “continue,” “could,” “intend,” “may,” “plan,” “potential,” “predict,” “should,” “will,” “expect,” “objective,” “projection,” “forecast,” “goal,” “guidance,” “outlook,” “effort,” “target” and other 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 undertake no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

ORION POWER HOLDINGS, INC.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholder
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, 2008 and 2007, and the related consolidated statements of operations, stockholder's equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2008. 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 audits 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, 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, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in note 8(d) to the consolidated financial statements, the Company changed its accounting for income tax uncertainties in 2007.

KPMG LLP

Houston, Texas
February 28, 2009

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

	2008	2007	2006
	(thousands of dollars)		
Revenues:			
Revenues.....	\$ 14,615	\$ 22,317	\$ 22,861
Revenues – affiliates.....	570,863	542,568	474,851
Total.....	585,478	564,885	497,712
Expenses:			
Cost of sales.....	247,817	227,240	222,358
Cost of sales – affiliates.....	(3,467)	(5,521)	2,427
Operation and maintenance.....	132,277	161,713	143,786
Operation and maintenance – affiliates.....	32,787	37,696	35,924
Taxes other than income taxes.....	10,587	11,570	13,089
General and administrative – primarily affiliates.....	24,626	27,685	27,980
Gains on sales of assets and emission allowances, net – primarily affiliates.....	(617)	(7,480)	(66,964)
Goodwill impairment.....	173,570	—	—
Depreciation and amortization.....	104,261	137,602	100,107
Total operating expenses.....	721,841	590,505	478,707
Operating Income (Loss).....	(136,363)	(25,620)	19,005
Other Income (Expense):			
Other, net.....	4,488	—	—
Interest expense.....	(23,284)	(34,314)	(38,472)
Interest expense – affiliates.....	(5,987)	(9,293)	(1,351)
Interest income – primarily affiliates.....	5,514	8,452	8,956
Total other expense.....	(19,269)	(35,155)	(30,867)
Loss from Continuing Operations Before Income Taxes			
Taxes.....	(155,632)	(60,775)	(11,862)
Income tax benefit.....	(26,323)	(25,737)	(31,135)
Income (Loss) from Continuing Operations.....	(129,309)	(35,038)	19,273
Income (loss) from discontinued operations.....	(1,480)	7,124	5,375
Net Income (Loss).....	\$ (130,789)	\$ (27,914)	\$ 24,648

See Notes to the Consolidated Financial Statements

ORION POWER HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2008	2007
	(thousands of dollars, except per share amounts)	
<i>ASSETS</i>		
Current Assets:		
Cash and cash equivalents	\$ 2	\$ 259
Accounts receivable, principally customer, net of allowance of \$0	21,971	102
Receivables from affiliates, net	45,383	19,968
State income taxes receivable	35,010	45,763
Inventory	73,564	57,233
Accumulated deferred income taxes	32,919	6,713
Collateral posted under agreement with Reliant Energy, Inc.	—	2,000
Prepayments and other current assets	1,454	1,843
Current assets of discontinued operations	—	2,132
Total current assets	210,303	136,013
Property, Plant and Equipment, net	1,720,944	1,619,651
Other Assets:		
Goodwill, net	—	173,570
Other intangibles, net	164,950	165,509
Long-term note receivable from Reliant Energy, Inc.	53,981	67,200
Long-term collateral posted under agreement with Reliant Energy, Inc.	14,392	14,392
Other	3,633	9,383
Total other assets	236,956	430,054
Total Assets	\$ 2,168,203	\$ 2,185,718
 <i>LIABILITIES AND STOCKHOLDER'S EQUITY</i>		
Current Liabilities:		
Current portion of long-term debt	\$ 12,531	\$ 11,409
Accounts payable, principally trade	47,860	36,278
Accrued interest payable	7,996	7,999
Other taxes payable	13,276	12,496
Derivatives liabilities	69,468	—
Other	23,242	17,530
Current liabilities of discontinued operations	2,952	—
Total current liabilities	177,325	85,712
Other Liabilities:		
Accumulated deferred income taxes	134,486	165,709
Benefit obligations	62,377	46,726
Taxes payable to Reliant Energy, Inc. and related accrued interest	87,408	66,294
Other	9,972	10,602
Long-term liabilities of discontinued operations	3,542	3,542
Total other liabilities	297,785	292,873
Revolving Credit Facility with Reliant Energy, Inc.	74,471	37,299
Long-term Debt	404,403	416,934
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	2,211,139	2,211,138
Accumulated deficit	(982,396)	(851,607)
Accumulated other comprehensive loss	(14,525)	(6,632)
Total stockholder's equity	1,214,219	1,352,900
Total Liabilities and Stockholder's Equity	\$ 2,168,203	\$ 2,185,718

See Notes to the Consolidated Financial Statements

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(thousands of dollars)		
Cash Flows from Operating Activities:			
Net income (loss).....	\$ (130,789)	\$ (27,914)	\$ 24,648
(Income) loss from discontinued operations.....	1,480	(7,124)	(5,375)
Net income (loss) from continuing operations.....	(129,309)	(35,038)	19,273
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Goodwill impairment.....	173,570	—	—
Depreciation and amortization.....	104,261	137,602	100,107
Deferred income taxes.....	(47,522)	(21,422)	(27,474)
Net changes in energy derivatives.....	69,468	1,108	(1,108)
Net amortization of contractual rights and obligations.....	(208)	(302)	(2,218)
Amortization of revaluation of acquired debt.....	(11,409)	(10,505)	(9,721)
Gains on sales of assets and emission allowances, net – primarily affiliates.....	(617)	(7,480)	(66,964)
Other, net.....	(1,777)	366	(658)
Changes in other assets and liabilities:			
Accounts receivable, net.....	(21,869)	1,562	2,415
Inventory.....	(16,331)	(7,384)	3,414
Other current assets.....	389	(539)	2,173
Other assets.....	380	4,867	10,036
Accounts payable.....	7,780	(27)	5,163
Payable to/receivable from affiliates, net.....	(5,764)	(14,840)	7,188
Collateral posted under agreement with Reliant Energy, Inc.....	2,000	(788)	(15,604)
Income taxes payable/receivable.....	18,633	22,938	13,510
Accrued interest.....	(3)	3	(4)
Long-term taxes payable to Reliant Energy, Inc. and related accrued interest.....	22,132	(18,015)	—
Other current liabilities.....	823	184	1,735
Other liabilities.....	3,281	(3,680)	3,726
Net cash provided by continuing operations from operating activities.....	167,908	48,610	44,989
Net cash provided by (used in) discontinued operations from operating activities.....	(56)	6,726	(49,689)
Net cash provided by (used in) operating activities.....	167,852	55,336	(4,700)
Cash Flows from Investing Activities:			
Capital expenditures.....	(174,287)	(109,212)	(45,566)
Proceeds from sales of assets, net.....	—	259	—
Proceeds from sales of emission allowances.....	515	624	1,134
Proceeds from sales of emission allowances – affiliates.....	164	12,678	69,320
Purchases of emission allowances – affiliates.....	(44,892)	(9,643)	—
Net cash provided by (used in) continuing operations from investing activities.....	(218,500)	(105,294)	24,888
Net cash provided by discontinued operations from investing activities.....	—	520	967,566
Net cash provided by (used in) investing activities.....	(218,500)	(104,774)	992,454
Cash Flows from Financing Activities:			
Distributions to Reliant Energy, Inc.....	—	—	(209,400)
Changes in revolving credit facility with Reliant Energy, Inc., net.....	37,172	24,616	12,683
(Loan to) repayments from Reliant Energy, Inc.....	13,219	25,000	(92,200)
Payments of long-term debt.....	—	—	(191)
Net cash provided by (used in) continuing operations from financing activities.....	50,391	49,616	(289,108)
Net cash used in discontinued operations from financing activities.....	—	—	(712,317)
Net cash provided by (used in) financing activities.....	50,391	49,616	(1,001,425)
Net Change in Cash and Cash Equivalents.....	(257)	178	(13,671)
Cash and Cash Equivalents at Beginning of Period.....	259	81	13,752
Cash and Cash Equivalents at End of Period.....	\$ 2	\$ 259	\$ 81
Supplemental Disclosure of Cash Flow Information:			
Cash Payments:			
Interest paid (net of amounts capitalized) to third parties for continuing operations.....	\$ 34,688	\$ 44,756	\$ 48,360
Income taxes paid (net of income tax refunds received) for continuing operations.....	(15,663)	(2,858)	(17,022)
Non-cash Disclosure:			
Distributions to Reliant Energy, Inc., net for continuing operations.....	—	—	(39,543)

See Notes to the Consolidated Financial Statements

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

	<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>				<u>Total Accumulated Other Comprehensive Income (Loss)</u>	<u>Discontinued Operations Accumulated Other Comprehensive Loss</u>	<u>Total Stockholder's Equity</u>	<u>Comprehensive Income (Loss)</u>
					<u>Deferred Derivative Gains (Losses)</u>	<u>Benefits Actuarial Net Gain (Loss)</u>	<u>Benefits Net Prior Service Costs</u>	<u>Additional Minimum Benefits Liability</u>				
	(thousands of dollars)											
Balance, December 31, 2005 ...	1,000	\$ 1	\$ 2,460,551	\$ (848,341)	\$ 18,847	\$ —	\$ —	\$ (147)	\$ 18,700	\$ (335)	\$ 1,630,576	\$ 24,648
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 from cash flow hedges into net income, 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	\$ (27,914)
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 into net loss, 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												<u>\$ (28,312)</u>
Balance, December 31, 2007 ...	1,000	\$ 1	\$ 2,211,139	\$ (851,607)	\$ —	\$ (4,296)	\$ (2,336)	\$ —	\$ (6,632)	\$ —	\$ 1,352,901	

(continued)

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 2,651 megawatts (MW) as of December 31, 2008. 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.

Review of Strategic Alternatives. In October 2008, Reliant Energy’s Board of Directors initiated a process to review strategic alternatives and formed a special committee to oversee this process. Reliant Energy is exploring a full range of possible strategic alternatives to enhance stockholder value, including, among other possibilities, the sale of all or substantially all of Reliant Energy (including Orion Power), as well as the sale of some or all of its retail business.

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 evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which Orion Power believes to be reasonable under the circumstances. Orion Power adjusts such estimates and assumptions when facts and circumstances dictate.

Orion Power’s critical accounting estimates include: (a) fair value of derivative assets and liabilities; (b) fair value of Orion Power for assessing impairments of recorded goodwill; (c) fair value of property, plant and equipment; (d) loss contingencies and (e) 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(i), 2(j), 2(n), 2(o), 2(p), 2(q), 4, 5, 6, 7, 8, 9, 10 and 14.

(b) Principles of Consolidation.

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

(c) **Revenues.**

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) **Fair Value Measurements.**

Summary. Effective January 1, 2008, Orion Power adopted Statement of Financial Accounting Standards (SFAS) No. 157, "Fair Value Measurements" (SFAS No. 157) on a prospective basis for its derivative assets and liabilities. In connection with the adoption, no cumulative effect of an accounting change was recognized. For non-financial assets and liabilities, the adoption of SFAS No. 157 was deferred until January 1, 2009. See note 2(s).

Fair Value Hierarchy and Valuation Techniques. Orion Power applies recurring fair value measurements to its derivative assets and liabilities. In determining fair value, Orion Power generally uses the market approach and incorporates assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation techniques. These inputs can be readily observable, market corroborated, or generally unobservable internally-developed inputs. Based on the observability of the inputs used in the valuation techniques, the derivative assets and liabilities are classified as follows:

Level 1: Level 1 represents unadjusted quoted market prices in active markets for identical assets or liabilities that are accessible at the measurement date.

Level 2: Level 2 represents quoted market prices for similar assets or liabilities in active markets, quoted market prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data.

Level 3: This category includes energy derivative instruments whose fair value is estimated based on prices in inactive markets that are not observable. Orion Power's OTC derivative instruments that are transacted in less liquid markets with limited pricing information are included in Level 3, which are coal contracts.

Nonperformance Risk on Derivative Liabilities. In accordance with SFAS No. 157, fair value measurement of Orion Power's derivative liabilities reflects the nonperformance risk related to that liability, which is its own credit risk. Orion Power derives its nonperformance risk by applying Reliant Energy, Inc.'s credit default swap spread against the respective derivative liability. As of December 31, 2008, Orion Power had \$5 million in reserves for nonperformance risk on derivative liabilities. This change in accounting estimate had an impact during 2008 as follows (income (loss)):

	2008	
	Income from Continuing Operations before Income Taxes	Net Income
	(in millions)	
Total derivatives liabilities	\$ 5	\$ 3

(1) Recorded in cost of sales as unrealized.

Fair Value of Derivative Instruments.

	December 31, 2008			
	Level 1	Level 2	Level 3	Total Fair Value
	(in millions)			
Total derivative assets	\$ —	\$ —	\$ —	\$ —
Total derivative liabilities	—	—	69	69

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

	<u>2008</u>
	<u>Net Derivatives</u>
	<u>(Level 3)</u>
	<u>(in millions)</u>
Balance, January 1, 2008.....	\$ —
Total gains (losses) realized/unrealized:	
Included in earnings	—
Purchases, issuances and settlements (net).....	(69)
Transfers in and/or out of Level 3 (net).....	—
Balance, December 31, 2008.....	<u>\$ (69)</u>
Changes in unrealized gains/losses relating to derivative assets and liabilities still held at December 31, 2008.....	—

(1) Represents fair value as of December 31, 2007.

See notes 2(e) and 5.

(e) 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).

Changes in commodity prices prior to the energy delivery period are inherent in Orion Power’s business. However, Orion Power believes the benefits of generally hedging its generation assets do not justify the costs, including collateral postings. Accordingly, Orion Power may enter selective hedges, including originated transactions, based on its assessment of (a) market fundamentals to increase the return from its generation assets and (b) operational and market limitations requiring Orion Power to enter into fuel transactions to manage its generation assets.

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. Fixed-price derivatives are used to fix the price for a portion of these transactions. The primary types of derivative instruments Orion Power uses are forwards 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 accounting) 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. See note 2(d) for discussion on fair value measurements.

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.

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:

<u>Instrument</u>	<u>Purpose for Holding or Issuing Instrument⁽¹⁾</u>	<u>Transactions that Physically Flow/Settle</u>	<u>Transactions that Financially Settle⁽²⁾</u>
Fuel forward and option contracts	Fuel sales Fuel purchases	Revenues Cost of sales	Cost of sales Cost of sales

(1) The purpose for holding or issuing does not impact 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.

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

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(f) for further discussion of Orion Power's credit policy.

Cash Flow Hedges. 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.

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, 2008 and 2007, Orion Power does not have any designated cash flow hedges.

Presentation of Derivative Assets and Liabilities. Orion Power adopted FIN 39-1 on January 1, 2008. Upon adoption it elected to present its derivative assets and liabilities on a gross basis (regardless of master netting arrangements with the same counterparty). Cash collateral amounts are also presented on a gross basis. Orion Power applied FIN 39-1 retrospectively for all financial statements presented. However, its December 31, 2007 consolidated balance sheet was not affected as there were no derivative contracts outstanding (accounted for under the mark-to-market or cash flow hedge accounting methods) as of that date.

(f) 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, 2008, two non-investment grade counterparties and two investment grade counterparties represented 45% (\$7 million) and 50% (\$8 million), respectively, of its credit exposure. As of December 31, 2008, Orion Power held no collateral from these counterparties. As of December 31, 2007, Orion Power had no credit exposure. There were no other counterparties representing greater than 10% of Orion Power's credit exposure.

(g) Customer Concentration.

The following table represents accounts receivable balances from third party customers in excess of 10% of the total consolidated accounts receivable balance and the related percentages as of December 31, 2008 (in millions, except percentages):

Customer	December 31, 2008	
	Accounts Receivable Balance	Percentage of Total Accounts Receivable
AEP Service Corporation	\$ 5	21%
Magnum Coal	4	19%
Conemaugh Fuels	3	14%
Consol Energy	3	15%

Accounts receivable from third parties was insignificant as of December 31, 2007.

(h) 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.

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

Orion Power computes depreciation using the straight-line method based on estimated useful lives. Depreciation expense was \$80 million, \$87 million and \$76 million during 2008, 2007 and 2006, respectively.

	Estimated Useful Lives (Years)	December 31,	
		2008	2007
(in millions)			
Electric generation facilities	20 — 32	\$ 1,831	\$ 1,823
Land improvements	20 — 32	96	98
Other	3 — 10	12	10
Land		13	12
Assets under construction		259	89
Total		2,211	2,032
Accumulated depreciation		(490)	(412)
Property, plant and equipment, net		\$ 1,721	\$ 1,620

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 2008, 2007 and 2006.

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.

(j) *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. See note 4.

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, 2008 and 2007.

(k) *Capitalization of Interest Expense.*

Orion Power capitalizes interest on capital projects greater than \$10 million and under development for one year or more. During 2008, 2007 and 2006, Orion power capitalized \$13 million, \$3 million and \$0 of interest expense, respectively, relating primarily to its scrubber project at the Cheswick plant.

(l) *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 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.

(m) *Cash and Cash Equivalents.*

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

(n) *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.

(o) **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,	
	2008	2007
	(in millions)	
Materials and supplies, including spare parts	\$ 24	\$ 21
Coal	49	34
Heating oil	1	2
Total inventory	<u>\$ 74</u>	<u>\$ 57</u>

(p) **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.

(q) **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 \$7 million and \$8 million as of December 31, 2008 and 2007, respectively. As of December 31, 2008 and 2007, Orion Power has \$2 million and \$3 million, respectively, (classified in other long-term assets) on deposit with the state of Pennsylvania to guarantee its obligation related to future closures of ash disposal landfill sites. See note 10.

(r) **Repair and Maintenance Costs for Power Generation Assets.**

Orion Power expenses repair and maintenance costs as incurred.

(s) **New Accounting Pronouncements Not Yet Adopted.**

Fair Value Measurement for Non-Financial Assets and Liabilities. For some non-financial assets and liabilities, the effective date for SFAS No. 157 fair value measurement criteria is January 1, 2009. Orion Power does not expect the standard to have a significant impact on its consolidated financial statements.

Disclosures about Derivatives and Hedging Activities. SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" (SFAS No. 161) is an amendment of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and is intended to enhance the related qualitative and quantitative disclosures by providing for additional information about objectives, strategies, accounting treatment, volume by commodity type and credit-risk-related contingent features. SFAS No. 161 was adopted on January 1, 2009.

Disclosures about Plan Assets. The FASB issued FSP FAS 132(R)-1, "Employer's Disclosures about Postretirement Benefit Plan Assets," which is effective for 2009. In addition to enhanced disclosures regarding investment policies and strategies, this FSP will require Orion Power to disclose information about fair value measurements of plan assets that would be similar to the disclosures about fair value measurements required by SFAS No. 157.

(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.

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

	<u>2008</u>	<u>2007</u> (in millions)	<u>2006</u>
Allocated or charged by Reliant Energy	\$ 57	\$ 65	\$ 64

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

	<u>2008</u>	<u>2007</u> (in millions)	<u>2006</u>
Sales to Reliant Energy under various commodity agreements ⁽¹⁾	\$ 571	\$ 543	\$ 475
Purchases from Reliant Energy under various commodity agreements ⁽²⁾	2	1	7
Gains on coal sales to Reliant Energy	6	6	5
Sales of emission allowances to Reliant Energy ⁽⁴⁾	—	13	69
Gains on emission allowances sales to Reliant Energy ⁽⁵⁾	—	6	66

(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 on a net basis.

(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 2009; 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 \$2 million, \$3 million and \$1 million during 2008, 2007 and 2006, 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 2008 and 2007, Reliant energy paid down \$13 million and \$25 million, respectively, on this loan. Orion Power has earned interest income related to this term loan of \$5 million, \$8 million and \$7 million during 2008, 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, 2008 and 2007, Reliant Energy posted letters of credit totaling \$14 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 December 31, 2008 and 2007, Orion Power has provided cash collateral of \$14 million and \$16 million, respectively, to Reliant Energy. During 2008, 2007 and 2006, the letters of credit costs, recorded in interest expense, were insignificant and related interest income was \$0, \$1 million and \$0, respectively.

Cash Distributions to Reliant Energy.

	<u>2008</u>	<u>2007</u>	<u>2006</u>
		(in millions)	
Orion Power Holdings cash distributions to Reliant Energy	\$ —	\$ —	\$ (209)

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
		(in millions)	
Non-cash contributions from (distributions to) Reliant Energy related to federal income taxes for continuing and discontinued operations.....	\$ —	\$ —	\$ (40)

As of December 31, 2008 and 2007, Orion Power has \$87 million and \$66 million, respectively, recorded as long-term taxes payable to Reliant Energy, Inc., which includes accrued interest payable of \$10 million and \$6 million, respectively. Orion Power has incurred interest expense related to this payable of \$4 million and \$6 million during 2008 and 2007, respectively.

(4) Intangible Assets

(a) Goodwill.

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

As of January 1, 2007	\$ 176
Changes	(2)
As of December 31, 2007	<u>174</u>
Impairment	<u>(174)</u>
As of December 31, 2008	<u>\$ —</u>

As of December 31, 2008 and 2007, Orion Power had \$30 million and \$35 million, respectively, of goodwill that is deductible for United States income tax purposes in future periods.

Orion Power tests goodwill for impairment on an annual basis in April, and more often if events or circumstances indicate there may be impairment. Orion Power continually assesses whether any indicators of impairment exist, which requires a significant amount of judgment. Such indicators may include a sustained significant decline in Reliant Energy, Inc.'s share price and market capitalization; a decline in expected future cash flows; a significant adverse change in legal factors or in the business climate; unanticipated competition; overall weakness in the industry; and slower growth rates. Any adverse change in these factors could have a significant impact on the recoverability of goodwill and could have a material impact on the consolidated financial statements.

During April, Orion Power tested goodwill for impairment and determined that no impairment existed.

During the third and fourth quarters of 2008, given recent adverse changes in the business climate and the credit markets, Reliant Energy, Inc.'s market capitalization being lower than its book value during all of the fourth quarter and extending into 2009, Reliant Energy's review of strategic alternatives to enhance stockholder value and reductions in the expected near-term cash flows from operations, Orion Power reviewed its goodwill for impairment.

Orion Power concluded that no goodwill impairment occurred as of September 30, 2008. As discussed below, as of December 31, 2008, Orion Power concluded that its goodwill of \$174 million was impaired. This charge is non-cash.

Goodwill is reviewed for impairments based on a two-step test. In the first step, Orion Power compares its fair value with its net book value. Orion Power must apply judgment in determining the fair value for purposes of performing the goodwill impairment test because quoted market prices for its business are not available. In estimating the fair value, Orion Power uses a combination of an income approach and a market-based approach.

- Income approach — Orion Power discounts its expected cash flows. The discount rate used represents the estimated weighted average cost of capital, which reflects the overall level of inherent risk involved in its operations and cash flows and the rate of return an outside investor would expect to earn. To estimate cash flows beyond the final year of its model, Orion Power applies a terminal value multiple to the final year EBITDA.
- Market-based approach — Orion Power uses the guideline public company method, which focuses on comparing its risk profile and growth prospects to select reasonably similar/guideline publicly traded companies. Orion Power also uses a public transaction method, which focuses on exchange prices in actual transactions as an indicator of fair value.

In weighting the results of the various valuation approaches, prior to the fourth quarter of 2008, Orion Power placed more emphasis on the income approach, using management's future cash flow projections and risk-adjusted discount rates. As Orion Power's earnings outlook declined, its earnings variability increased and Reliant Energy, Inc.'s market capitalization declined significantly in 2008, Orion Power increased the weighting of the estimates of fair value determined by the market-based approaches. Further, the aggregate estimated fair value of Reliant Energy's reporting units was compared to its total market capitalization, adjusted for a control premium. A control premium is added to the market capitalization to reflect the value that exists with having control over an entire entity.

If the estimated fair value is higher than the recorded net book value, no impairment is considered to exist and no further testing is required. However, if the estimated fair value is below the recorded net book value, a second step must be performed to determine the goodwill impairment required, if any. In the second step, the estimated fair value from the first step is used as the purchase price in a hypothetical acquisition, which is then allocated to the entity's assets and liabilities in accordance with purchase accounting rules. The residual amount of goodwill that results from this hypothetical purchase price allocation is compared to the recorded amount of goodwill for the entity, and the recorded amount is written down to the hypothetical amount, if lower.

Orion Power estimates its fair value based on a number of subjective factors, including: (a) appropriate weighting of valuation approaches, as discussed above, (b) projections about the future power generation margins, (c) estimates of future cost structure, (d) environmental assumptions, (e) risk-adjusted discount rates for estimated cash flows, (f) selection of peer group companies for the public company market approach, (g) required level of working capital, (h) assumed EBITDA multiple for terminal values and (i) time horizon of cash flow forecasts.

As part of the process, Orion Power develops 15-year forecasts of earnings and cash flows, assuming that demand for power grows at the rate of two percent a year. It models all of its power generation facilities and those of others in the regions in which Orion Power operates, using these assumptions: (a) the markets in which Orion Power operates will continue to be deregulated and earn a market return; (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, which implies that margins and therefore cash flows in the future would be better than they are today because market prices will need to rise high enough to provide an incentive for new plants to be built, and the entire market will realize the benefit of those higher margins 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, which implies that the revenues and margins described in (b) above will be at the level of return required for a regulated entity instead of a deregulated company. Orion Power assumes that the after-tax rate of return on new construction is 7.5%.

Orion Power's assumptions for each of its goodwill impairment assessments during 2006, 2007 and 2008:

	<u>April 2006</u>	<u>April 2007</u>	<u>April 2008</u>	<u>September 2008</u>	<u>December 2008</u>
<u>Income approach assumptions</u>					
EBITDA multiple for terminal values ⁽¹⁾	7.0	8.0	8.0	7.0	7.0
Risk-adjusted discount rate for estimated cash flows ⁽²⁾	9.5%	10.0%	10.5%	11.5%	13.0%
<u>Market-based approach</u>					
EBITDA multiple for publicly traded company	8	8	8	5	6
<u>Valuation approach weightings</u> ⁽³⁾					
Income approach	60%	70%	60%	80%	25%
Market-based approach	40%	30%	40%	20%	75%

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

(2) Increased primarily due to capital structure of peer company comparisons and increased required rate of return on debt and equity capital of peer companies.

(3) Changed primarily due to increased focus on market-based approaches. See discussion above.

Based on Orion Power's analysis, it concluded that it did not pass the first step as of December 31, 2008, primarily due to lower expected cash flows due to the adverse business climate, significantly lower expected exchange transaction values due to credit market disruptions which would make it difficult for transactions to occur and increase the price of those transactions and significantly lower valuations for the peer companies. In addition, when Reliant Energy compared the aggregate of its fair value estimates of both reporting units to its market capitalization, including a control premium, it determined that the market participants' views of its fair value had also declined significantly.

Orion Power then performed the second step of the impairment test, which requires an allocation of the fair value as the purchase price in a hypothetical acquisition of the entity. The significant hypothetical purchase price allocation adjustments made to the assets and liabilities of Orion Power consisted of the following:

- Adjusting the carrying value of property, plant and equipment to values that would be expected in the current credit and market environment;
- Adjusting the carrying value of emission allowances, which currently trade at amounts significantly higher than book value;
- Adjusting the carrying value of debt, which has a lower fair value than book value; and
- Adjusting deferred income taxes for changes in the balances listed above.

After making these hypothetical adjustments, no residual value remained for a goodwill allocation resulting in the impairment of Orion Power's goodwill net carrying amount of \$174 million as of December 31, 2008.

(b) *Other Intangibles.*

	Remaining Weighted Average Amortization Period (Years)	December 31			
		2008		2007	
		Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
(in millions)					
SO ₂ emission allowances ⁽¹⁾⁽²⁾	— ⁽¹⁾	\$ 68 ⁽³⁾	\$ (12) ⁽³⁾	\$ 160 ⁽³⁾	\$ (103) ⁽³⁾
NO _x emission allowances ⁽¹⁾⁽⁴⁾	— ⁽¹⁾	109 ⁽³⁾	— ⁽³⁾	180 ⁽³⁾	(71) ⁽³⁾
Total		\$ 177	\$ (12)	\$ 340	\$ (174)

- (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, 2008, 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 2008, 2007 and 2006, Orion Power purchased \$18 million, \$28 million and \$0, respectively, of SO₂ emission allowances from affiliates.
- (3) During 2008, Orion Power wrote off the fully amortized carrying amount and accumulated amortization for SO₂ and NO_x emission allowances of \$110 million and \$76 million, respectively.
- (4) During 2008, 2007 and 2006, Orion Power purchased \$5 million, \$4 million and \$0, respectively, of NO_x emission allowances from affiliates.

Amortization expense consists of:

	2008	2007	2006
	(in millions)		
Emission allowances	\$ 24	\$ 50	\$ 25
Contractual rights ⁽¹⁾	\$ —	\$ —	\$ (1)
Contractual obligations ⁽¹⁾⁽²⁾	—	—	3
Net	\$ —	\$ —	\$ 2

- (1) Contractual rights and contractual obligations are 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. The contractual rights were fully amortized as of December 31, 2006.
- (2) Contractual obligations are classified as other long-term liabilities.

Estimated amortization expense based on Orion Power's intangibles as of December 31, 2008 for the next five years is (in millions):

2009	\$ 6	(1)
2010	7	(1)
2011	7	(1)
2012	7	(1)
2013	7	(1)

- (1) These amounts do not include expected amortization expense of emission allowances, which have not been purchased as of December 31, 2008.

(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(e).

During 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 2006, \$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.

During 2008, Orion Power entered into two forward coal contracts and the unrealized losses associated with these contracts are \$69 million, which are included in cost of sales.

As of December 31, 2008 and 2007, Orion Power does not have any designated cash flow hedges and there are no deferred derivative gains/losses remaining in accumulated other comprehensive loss.

(6) Debt

Outstanding debt to third parties:

	December 31,					
	2008			2007		
	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⁾		4	13		17	11
Total debt.....		<u>\$ 404</u>	<u>\$ 13</u>		<u>\$ 417</u>	<u>\$ 11</u>

(1) The weighted average stated interest rates are as of December 31, 2008 or 2007.

(2) Debt acquired by Reliant Energy in the Orion Power acquisition was adjusted to fair value as of the acquisition date. Included in interest expense is amortization of \$11 million, \$11 million and \$9 million for valuation adjustments for debt during 2008, 2007 and 2006, respectively.

Debt maturities as of December 31, 2008 are (in millions):

2009	\$	—
2010		400
2011		—
2012		—
2013		—
2014 and thereafter		—
	<u>\$</u>	<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, 2008, conditions under these covenants were not met that allow the payment of dividends by Orion Power Holdings. As of December 31, 2008, 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.

The benefit obligations and funded status are:

	Pension		Postretirement Benefits	
	2008	2007	2008	2007
	(in millions)			
Change in Benefit Obligation				
Beginning of year	\$ 60	\$ 57	\$ 33	\$ 31
Service cost.....	3	2	—	1
Interest cost.....	3	3	2	2
Benefits paid.....	(2)	(2)	—	—
Amendments/adjustments.....	1	—	2	—
Actuarial gain	—	—	(4)	(1)
End of year.....	\$ 65	\$ 60	\$ 33	\$ 33
Change in Plan Assets				
Beginning of year	\$ 46	\$ 36	\$ —	\$ —
Employer contributions	3	9	—	—
Benefits paid.....	(2)	(2)	—	—
Actual investment return	(13)	3	—	—
End of year.....	\$ 34	\$ 46	\$ —	\$ —
Funded Status	\$ (31)	\$ (14)	\$ (33)	\$ (33)

Amounts recognized in the consolidated balance sheets are:

	Pension		Postretirement Benefits	
	December 31,		December 31,	
	2008	2007	2008	2007
	(in millions)			
Current liabilities.....	\$ —	\$ —	\$ (1)	\$ (1)
Noncurrent liabilities.....	(31)	(14)	(32)	(32)
Net amount recognized.....	\$ (31)	\$ (14)	\$ (33)	\$ (33)

The accumulated benefit obligation for all pension plans was \$59 million and \$54 million as of December 31, 2008 and 2007, respectively. All pension plans have accumulated benefit obligations in excess of plan assets.

Net periodic benefit costs are:

	Pension			Postretirement Benefits		
	2008	2007	2006	2008	2007	2006
	(in millions)					
Service cost	\$ 3	\$ 3	\$ 3	\$ —	\$ —	\$ —
Interest cost	3	3	3	2	2	2
Expected return on plan assets.....	(3)	(3)	(2)	—	—	—
Adjustment to annual expense.....	—	—	—	2	—	—
Net amortization.....	1	1	1	—	—	—
Net periodic benefit costs	<u>\$ 4</u>	<u>\$ 4</u>	<u>\$ 5</u>	<u>\$ 4</u>	<u>\$ 2</u>	<u>\$ 2</u>

As of December 31, 2008, \$1 million and \$0.6 million of net actuarial 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.

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

	Pension		Postretirement Benefits	
	December 31,		December 31,	
	2008	2007	2008	2007
Discount rate.....	5.75%	5.75%	5.75%	5.75%
Rate of compensation increase	3.0%	3.0%	N/A	N/A

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

	Pension			Postretirement Benefits		
	2008	2007	2006	2008	2007	2006
Discount rate.....	5.75%	5.75%	5.75%	5.75%	5.75%	5.75%
Rate of compensation increase	3.0%	3.0%	3.0%	N/A	N/A	N/A
Expected long-term rate of return on plan assets.....	7.5%	7.5%	7.5%	N/A	N/A	N/A

As of December 31, 2008 and 2007, 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:

	2008	2007	2006
Health care cost trend rate assumed for next year ⁽¹⁾	7.9%	8.3%	9.0%
Rate to which the cost trend rate is assumed to gradually decline (ultimate trend rate) ⁽¹⁾	5.5%	5.5%	5.5%
Year that the rate reaches the ultimate trend rate.....	2015	2015	2015

(1) Represents blended rate for medical and prescription drug costs.

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, 2008:

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

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

	Percentage of Plan Assets		Target Allocation
	as of December 31,		2009
	2008	2007	
Domestic equity securities	36%	49%	40%
International equity securities	21	10	20
Global equity securities	9	10	10
Debt securities	34	31	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	MSCI U.S. Broad Market Index	40%
International equity securities	MSCI All Country World Ex-U.S. Index	20
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 expects pension cash contributions to approximate \$13 million during 2009. Expected benefit payments for the next ten years, which reflect future service as appropriate, are:

	Postretirement	
	Pension	Benefits
	(in millions)	
2009	\$ 2	\$ 1
2010	3	1
2011	3	2
2012	4	2
2013	4	2
2014-2018	25	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, \$2 million and \$1 million during 2008, 2007 and 2006, respectively.

(c) *Other Employee Matters.*

As of December 31, 2008, approximately 75% of Orion Power's employees are subject to collective bargaining arrangements. Approximately 50% of Orion Power's employees are subject to collective bargaining arrangements that will expire in 2009. Orion Power intends to negotiate the renewal of these agreements.

(8) **Income Taxes**

(a) *Summary.*

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(in millions)		
Current:			
Federal.....	\$ 18	\$ —	\$ —
State.....	3	(4)	(4)
Total current.....	<u>21</u>	<u>(4)</u>	<u>(4)</u>
Deferred:			
Federal.....	(56)	(18)	11
State.....	9	(4)	(38)
Total deferred.....	<u>(47)</u>	<u>(22)</u>	<u>(27)</u>
Income tax expense (benefit) from continuing operations.....	<u>\$ (26)</u>	<u>\$ (26)</u>	<u>\$ (31)</u>
Income tax benefit from discontinued operations.....	<u>\$ (2)</u>	<u>\$ —</u>	<u>\$ (1)</u>

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Federal statutory rate.....	(35)%	(35)%	(35)%
Additions (reductions) resulting from:			
State income taxes, net of federal income taxes.....	5	(9)	(254) ⁽¹⁾
Goodwill impairment.....	14	—	—
Other, net.....	(1)	2	27
Effective rate.....	<u>(17)%</u>	<u>(42)%</u>	<u>(262)%</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,	
	2008	2007
	(in millions)	
Deferred tax assets:		
Current:		
Derivative liabilities, net.....	\$ 27	\$ —
Employee benefits.....	1	1
Valuation allowances.....	(1)	—
Other.....	5	4
Total current deferred tax assets.....	<u>32</u>	<u>5</u>
Long-term:		
Employee benefits.....	21	18
Net operating loss carryforwards.....	35	29
Other.....	7	13
Valuation allowances.....	(20)	(3)
Total long-term deferred tax assets.....	<u>43</u>	<u>57</u>
Total deferred tax assets.....	<u>\$ 75</u>	<u>\$ 62</u>
Deferred tax liabilities:		
Long-term:		
Depreciation and amortization.....	\$ 175	\$ 215
Total long-term deferred tax liabilities.....	<u>175</u>	<u>215</u>
Total deferred tax liabilities.....	<u>\$ 175</u>	<u>\$ 215</u>
Accumulated deferred income taxes, net.....	<u>\$ (100)</u>	<u>\$ (153)</u>

(b) Tax Attribute Carryovers.

	December 31, 2008	Statutory Carryforward Period	Expiration Years
	(in millions)	(in years)	
Net Operating Loss Carryforwards:			
State.....	\$ 568	20	2018 through 2028

(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 (in millions):

	State
As of January 1, 2006.....	\$ 24
Changes in valuation allowance.....	(19)
As of December 31, 2006.....	5
Changes in valuation allowance.....	(2)
As of December 31, 2007.....	3
Changes in valuation allowance.....	18
As of December 31, 2008.....	<u>\$ 21</u>

(d) **FIN 48 and Income 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 Energy'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. 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)

Orion Power's unrecognized tax benefits for federal and state changed as follows:

	<u>2008</u>	<u>2007</u>
	(in millions)	
Beginning of year	\$ —	\$ —
Increases related to prior years	4	2
Decreases related to prior years	(4)	(2)
Increases related to current year	—	—
Settlements	—	—
Lapses in the statute of limitations	—	—
End of year	<u>\$ —</u>	<u>\$ —</u>

As of January 1, 2007 and December 31, 2007 and 2008, Orion Power had no amounts accrued for interest or penalties. During 2008, 2007 and 2006, Orion Power recognized \$0, \$0 and an insignificant amount, respectively, 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 2008	1997 to 2006
Pennsylvania.....	2004 to 2008	2005 to 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 timing of tax deductions for depreciation and emission allowances and believes it is reasonably possible some of these matters could be resolved during 2009; however, Orion Power cannot estimate the range of changes that might occur.

(9) Commitments

(a) Lease Commitments.

Operating Lease Expense. Total lease expense for all operating leases was \$2 million during 2008, 2007 and 2006.

(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, 2008.

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.

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 purchase and sales agreements, service agreements and procurement agreements.

Except as otherwise noted, 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, 2008, Orion Power has contractual commitments to spend approximately \$99 million on plant and equipment relating primarily to SO₂ emissions reductions, ash landfill projects and mercury controls.

Fuel Supply Commitments. Orion Power is a party to fuel supply contracts of various quantities and durations that are not classified as derivative assets and liabilities. These contracts are not included in the consolidated balance sheet as of December 31, 2008. Minimum purchase commitment obligations under these agreements are as follows as of December 31, 2008 (in millions):

	<u>Fuel Commitments⁽¹⁾</u>	
2009	\$	70
2010		35
2011		—
2012		—
2013 and thereafter		—
Total	\$	<u>105</u>

(1) As of December 31, 2008, the maximum remaining terms under any individual fuel supply contract is two years.

(2) Price estimated based on forward commodity curves as of December 31, 2008.

Other Commitments. Orion Power has other fixed commitments related to various agreements that aggregate as follows (in millions):

2009.....	\$	5
2010.....		3
2011.....		—
2012.....		—
2013.....		—
2014 and thereafter.....		—
Total.....	\$	<u>8</u>

(10) Contingencies

Orion Power is involved in some 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.” In September 2008, Orion Power received an EPA request for information related to its Avon Lake and Niles generation facilities. The EPA agreed to share information relating to its investigations with state environmental agencies.

Ash Disposal Landfill Closures. Orion Power is responsible for environmental costs related to the future closures of two ash disposal landfills owned by Orion MidWest. Orion Power recorded the estimated discounted costs (\$7 million and \$8 million as of December 31, 2008 and 2007, respectively) associated with these environmental liabilities as part of its asset retirement obligations. See note 2(q).

Sales Tax Contingencies. Some of Orion Power’s sales tax computations are subject to challenge under audit. As of December 31, 2008 and 2007, Orion Power has \$2 million and \$0, respectively, accrued in current liabilities of discontinued operations relating to these contingencies.

Property Tax Contingencies. Orion Power believes it will be subject to additional property tax liabilities related to years 2001 to 2005. As of December 31, 2008 and 2007, Orion Power has \$4 million accrued in long-term liabilities of discontinued operations relating to these contingencies.

(11) Settlement

In October 2008, Orion Power settled its claims in a suit it filed based on breach of a fuel supply agreement. Under the settlement agreement, Orion Power received settlement payments totaling \$20 million (recorded in cost of sales).

(12) 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,			
	2008		2007	
	Carrying Value	Fair Value ⁽¹⁾	Carrying Value	Fair Value ⁽¹⁾
	(in millions)			
Fixed rate debt.....	\$ 417	\$ 397	\$ 428	\$ 436
Total debt.....	<u>\$ 417</u>	<u>\$ 397</u>	<u>\$ 428</u>	<u>\$ 436</u>

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

(13) Sales of Assets and Emission Allowances

Emission Allowances. Orion Power sold emission allowances (primarily SO₂) during 2008, 2007 and 2006 for gains of \$1 million, \$7 million and \$67 million, respectively.

(14) Discontinued Operations

New York Plants. 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. 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.

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

The following summarizes certain financial information of the New York plants reported as discontinued operations (in millions):

	<u>New York Plants</u>	
<u>2008</u>		
Revenues.....	\$ —	
Loss before income tax expense/benefit.....	(4)	
<u>2007</u>		
Revenues.....	\$ 3	
Income before income tax expense/benefit.....	7	
<u>2006</u>		
Revenues.....	\$ 104	
Income before income tax expense/benefit.....	4	(1)

(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 was \$308 million.

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 and sales and use tax settlements. These amounts are classified as discontinued operations in the results of operations and consolidated balance sheets, as applicable. See note 10.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Business Overview

Orion Power owns and operates electric generation facilities in Ohio and Pennsylvania with an aggregate generating capacity of 2,651 megawatts (MW) as of December 31, 2008. 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.

Orion Power's business is a capital-intensive, cyclical business. Earnings are significantly impacted by spark and dark spreads and capacity prices. Spark and dark spreads are driven by a number of factors, including the prices of power, natural gas, coal and fuel oil, the cost of emissions, transmission, weather and global macro-economic factors, none of which we control and many of which are volatile. The factor that we have the most control over is the percentage of time that our generating assets are available to run when it is economical for them to do so (commercial capacity factor). The key earnings drivers in our business include the amount of time our power plants are economical to operate (economic generation) and commercial capacity factor, which both determine the amount of electricity we generate, the margin we earn for each unit of electricity sold, the availability of our generating assets to meet demand and capacity revenues (other margin) and operating costs.

Consolidated Results of Operations

2008 Compared to 2007

Net Income (Loss). We reported \$131 million consolidated net loss for 2008 compared to \$28 million consolidated net loss for 2007.

	2008	2007	Change from 2007 to 2008
	(in millions)		
Gross margin ⁽¹⁾	\$ 341	\$ 343	\$ (2)
Operation and maintenance	(132)	(161)	29
Operation and maintenance – affiliates	(33)	(38)	5
Taxes other than income taxes.....	(11)	(12)	1
General and administrative – primarily affiliates	(24)	(28)	4
Gains on sales of assets and emission allowances, net – primarily affiliates	1	7	(6)
Goodwill impairment.....	(174)	—	(174)
Depreciation and amortization.....	(104)	(137)	33
Other, net	4	—	4
Interest expense	(23)	(34)	11
Interest expense – affiliates	(6)	(9)	3
Interest income – primarily affiliates.....	6	9	(3)
Income tax benefit	26	25	1
Loss from continuing operations	(129)	(35)	(94)
Income (loss) from discontinued operations.....	(2)	7	(9)
Net loss	<u>\$ (131)</u>	<u>\$ (28)</u>	<u>\$ (103)</u>

(1) Revenues less cost of sales.

Revenues (including from affiliates).

	<u>2008</u>	<u>2007</u> (in millions)	<u>Change from 2007 to 2008</u>	
Third-party revenues.....	\$ 14	\$ 22	\$ (8)	(1)
Revenues – affiliates.....	571	543	28	(2)
Revenues.....	<u>\$ 585</u>	<u>\$ 565</u>	<u>\$ 20</u>	

- (1) Decrease primarily due to a reliability-must-run contract from May 2006 to July 2007.
(2) Merchant sales to PJM Interconnection, LLC through Reliant Energy increased due to (a) higher market prices and (b) higher RPM capacity payments. This increase was partially offset by a decrease in power sales volumes. RPM is the model utilized by the PJM Interconnection, LLC to meet load serving entities forecasted capacity obligations via a forward-looking commitment of capacity resources.

Cost of Sales (including from affiliates).

	<u>2008</u>	<u>2007</u> (in millions)	<u>Change from 2007 to 2008</u>	
Cost of sales.....	\$ 179	\$ 226	\$ (47)	(1)
Cost of sales – affiliates.....	(4)	(5)	1	(2)
Unrealized losses on energy derivatives.....	69	1	68	
Cost of sales.....	<u>\$ 244</u>	<u>\$ 222</u>	<u>\$ 22</u>	

- (1) Decrease primarily due to (a) decreased coal volumes, (b) margin on sale of coal and (c) \$20 million litigation settlement received from coal supplier. This decrease was partially offset by higher coal prices.
(2) Relates to purchases from an affiliate to meet requirements of contractual commitments.

Gross Margin.

	<u>2008</u>	<u>2007</u> (in millions)	<u>Change from 2007 to 2008</u>	
Orion MidWest.....	\$ 410	\$ 344	\$ 66	(1)
Net unrealized losses on energy derivatives.....	(69)	(1)	(68)	(2)
Gross margin.....	<u>\$ 341</u>	<u>\$ 343</u>	<u>\$ (2)</u>	

- (1) Increase primarily due to (a) realized gains on fuel hedges, (b) increased commercial capacity factor due to lower planned and unplanned outages in 2008, (c) higher RPM capacity payments and (d) \$20 million litigation settlement received from coal supplier. This increase was partially offset by (a) decreased economic generation and (b) lower unit margins (higher fuel costs partially offset by higher power prices).
(2) Decrease primarily due to changes in prices on our energy derivatives marked to market.

Operation and Maintenance (including from affiliates).

	<u>2008</u>	<u>2007</u> (in millions)	<u>Change from 2007 to 2008</u>	
Planned outages and maintenance spending.....	\$ 72	\$ 101	\$ (29)	(1)
Plant support costs.....	57	61	(4)	
Commercial support allocations.....	27	30	(3)	
Other, net.....	9	7	2	
Operation and maintenance (including from affiliates).....	<u>\$ 165</u>	<u>\$ 199</u>	<u>\$ (34)</u>	

- (1) Decrease primarily due to lower planned outage and maintenance spending at Elrama and Avon Lake in 2008.

Taxes Other than Income Taxes.

	<u>2008</u>	<u>2007</u> (in millions)	<u>Change from 2007 to 2008</u>
Property taxes	\$ 9	\$ 10	\$ (1)
Other, net	2	2	—
Taxes other than income taxes	<u>\$ 11</u>	<u>\$ 12</u>	<u>\$ (1)</u>

General and Administrative — Primarily Affiliates.

	<u>2008</u>	<u>2007</u> (in millions)	<u>Change from 2007 to 2008</u>
Allocations from Reliant Energy	\$ 24	\$ 28	\$ (4)
General and administrative – primarily affiliates.....	<u>\$ 24</u>	<u>\$ 28</u>	<u>\$ (4)</u>

Gains on Sales of Assets and Emission Allowances, Net — Primarily Affiliates.

	<u>2008</u>	<u>2007</u> (in millions)	<u>Change from 2007 to 2008</u>
Emission allowances.....	\$ 1	\$ 7	\$ (6)
Gains on sales of assets and emission allowances, net – primarily affiliates	<u>\$ 1</u>	<u>\$ 7</u>	<u>\$ (6)</u>

Goodwill Impairment. See note 4 to our consolidated financial statements.

Depreciation and Amortization.

	<u>2008</u>	<u>2007</u> (in millions)	<u>Change from 2007 to 2008</u>
Depreciation on plants	\$ 80	\$ 87	\$ (7) ⁽¹⁾
Amortization of emission allowances.....	24	50	(26) ⁽²⁾
Depreciation and amortization	<u>\$ 104</u>	<u>\$ 137</u>	<u>\$ (33)</u>

(1) Decrease primarily due to early retirements of plant components when replacement components are installed for upgrades (from \$13 million in 2007 to \$1 million in 2008).

(2) Decrease primarily due to (a) decrease in SO₂ and NO_x allowances used and (b) decrease in average cost of SO₂ allowances purchased and used.

Interest Expense (including from affiliates).

	<u>2008</u>	<u>2007</u> (in millions)	<u>Change from 2007 to 2008</u>
Interest expense	\$ 36	\$ 37	\$ (1)
Interest expense – affiliates	6	9	(3)
Capitalized interest ⁽¹⁾	<u>(13)</u>	<u>(3)</u>	<u>(10)</u>
Interest expense (including from affiliates)	<u>\$ 29</u>	<u>\$ 43</u>	<u>\$ (14)</u>

(1) Relates primarily to a scrubber project at our Cheswick plant.

Interest Income — Primarily Affiliates.

	<u>2008</u>	<u>2007</u> (in millions)	<u>Change from 2007 to 2008</u>
Interest income on note receivable from Reliant Energy, Inc.....	\$ 5	\$ 8	\$ (3)
Other, net	<u>1</u>	<u>1</u>	<u>—</u>
Interest income – primarily affiliates	<u>\$ 6</u>	<u>\$ 9</u>	<u>\$ (3)</u>

Income Tax Benefit. See note 8 to our consolidated financial statements.

Income (Loss) from Discontinued Operations. See note 14 to our consolidated financial statements.

Quantitative and Qualitative Disclosures About Market Risk

Our primary market risk exposure relates to fluctuations in commodity prices, principally, natural gas, power, coal and oil. As described in notes 2(e) and 2(f) to our consolidated financial statements, we have a risk control framework to manage our risk exposure. However, the effectiveness of this framework can never be completely estimated or fully assured. For example, we could experience volatility in earnings from basis price differences, transmission issues, price correlation issues, volume variation or other factors, including margins being compressed as a result of market prices behaving differently than expected. In addition, a reduction in market liquidity may impair the effectiveness of our risk management practices and resulting hedge strategies. These and other factors could have a material adverse effect on our results of operations, financial condition and cash flows.

Non-trading Market Risks

Commodity Price Risk

Changes in commodity prices prior to the energy delivery period are inherent in our business. However, we believe the benefits of generally hedging our generation assets do not justify the costs, including collateral postings. Accordingly, we may enter selective hedges, including originated transactions, based on our assessment of (a) market fundamentals to increase the return from our generation assets and (b) operational and market limitations requiring us to enter into fuel transactions to manage our generation assets. We use derivative instruments such as forwards and options to execute our hedge strategy. For further discussion of these strategies and related market risks, see notes 2 and 5 to our consolidated financial statements.

As of December 31, 2007, all derivative contracts accounted for under the mark-to-market and cash flow hedge accounting methods had settled over the contract terms.

During 2008, we entered into two forward coal contracts. As of December 31, 2008, the fair value of these contracts was \$69 million liability, classified as Level 3 based on the observability of the inputs used in the valuation technique. See notes 2(d) and 5 to our consolidated financial statements.

The fair value is subject to significant changes due to fluctuating coal forward market prices, volatility and credit risk. Market prices assume a functioning market with an adequate number of buyers and sellers to provide liquidity. Insufficient market liquidity could significantly affect the value that could be obtained for these contracts, as well as the cost at which these contracts could be hedged. Both contracts settle throughout 2009.

As of December 31, 2008, a hypothetical 10% decrease in the underlying energy prices would have a \$14 million potential loss impact on earnings and total fair value of the derivatives.

This risk analysis does not include the favorable impact that the same hypothetical price movement would have on our physical purchases and sales of fuel to which the hedges relate. The adverse impact of changes in commodity prices on our portfolio of non-trading energy derivatives would be offset (although not necessarily in the same period) by a favorable impact on the underlying physical transactions, assuming:

- the derivatives are not closed out in advance of their expected term;
- the derivatives continue to function effectively as hedges of the underlying risk; and
- as applicable, anticipated underlying transactions settle as expected.

If any of these assumptions cease to be true, we may experience a benefit or loss relative to the underlying exposure.

Interest Rate Risk

If interest rates decreased by one percentage point from their December 31, 2008 and 2007 levels, the fair values of our fixed rate debt would have increased by \$5 million and \$9 million, respectively.

Unaudited Quarterly Information

	2008			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(in millions)			
Revenues	\$ 177	\$ 163	\$ 159	\$ 86
Income (loss) from continuing operations.....	20	10	17	(176)
Loss from discontinued operations.....	—	(1)	—	(1)
Net income (loss).....	20	9	17	(177)

	2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(in millions)			
Revenues	\$ 144	\$ 117	\$ 163	\$ 141
Loss from continuing operations.....	(4)	(22)	(2)	(7)
Income (loss) from discontinued operations.....	(1)	(2)	2	8
Net income (loss).....	(5)	(24)	—	1

Variances in revenues and gross margin from quarter to quarter were primarily due to (a) seasonal fluctuations in demand for electric energy and energy services and (b) changes in energy commodity prices. Changes in net income (loss) were primarily due to these factors and the timing of maintenance expenses.

In addition, net income (loss) changed from quarter to quarter in 2008 by (amounts are pre-tax unless indicated otherwise):

- \$174 million goodwill impairment in the fourth quarter; and
- \$20 million settlement with a coal supplier paid to Orion Power in the fourth quarter.

Also, net income (loss) changed from quarter to quarter in 2007 by (amounts are pre-tax unless indicated otherwise):

- \$13 million charge for early retirements in depreciation expense (\$1 million in the first quarter, \$11 million in the second quarter and \$1 million in the third quarter).

**Ratio of Earnings from Continuing Operations to Fixed Charges
(Unaudited)**

	<u>2008⁽¹⁾</u>	<u>2007⁽²⁾</u>	<u>2006⁽³⁾</u>	<u>2005</u>	<u>2004⁽⁴⁾</u>
	(in thousands)				
Fixed charges:					
Interest expense, including					
affiliates	\$ 29,271	\$ 43,607	\$ 39,823	\$ 40,857	\$ 42,090
Capitalized interest	13,289	3,244	—	—	—
Interest within rent expense	6	11	66	227	376
Total fixed charges	<u>42,566</u>	<u>46,862</u>	<u>39,889</u>	<u>\$ 41,084</u>	<u>\$ 42,466</u>
Earnings from continuing operations:					
Income (loss) from continuing operations before income taxes.	\$(155,632)	\$ (60,775)	\$ (11,862)	\$ 72,982	\$(139,850)
Subtotal	<u>(155,632)</u>	<u>(60,775)</u>	<u>(11,862)</u>	<u>72,982</u>	<u>(139,850)</u>
Plus –					
Fixed charges from above.....	42,566	46,862	39,889	41,084	42,466
Amortization of capitalized interest	275	54	—	—	—
Less –					
Capitalized interest	<u>(13,289)</u>	<u>(3,244)</u>	<u>—</u>	<u>—</u>	<u>—</u>
	<u>\$ (126,080)</u>	<u>\$ (17,103)</u>	<u>\$ 28,027</u>	<u>\$ 114,066</u>	<u>(97,384)</u>
Ratio of earnings from continuing operations to fixed charges	<u>—</u> ⁽¹⁾	<u>—</u> ⁽²⁾	<u>—</u> ⁽³⁾	<u>2.78</u>	<u>—</u> ⁽⁴⁾

(1) For 2008, earnings were insufficient to cover fixed charges by \$169 million.

(2) For 2007, earnings were insufficient to cover fixed charges by \$64 million.

(3) For 2006, earnings were insufficient to cover fixed charges by \$12 million.

(4) For 2004, earnings were insufficient to cover fixed charges by \$140 million.