UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2002

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______________ to _______________

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Commission file number 1-13265

RELIANT ENERGY RESOURCES CORP.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 76-0511406 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 1111 Louisiana<br>Houston, Texas | 77002 |
| (Address of principal executive offices) | (Zip Code) |

(713) 207-3000
(Registrant's telephone number, including area code)

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RELIANT ENERGY RESOURCES CORP. MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1)(a) AND (b) OF FORM 10-Q AND IS THEREFORE FILING THIS FORM 10-Q WITH THE REDUCED DISCLOSURE FORMAT.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X]  No [ ]

As of August 9, 2002, all 1,000 shares of Reliant Energy Resources Corp. common stock were held by Reliant Energy, Incorporated.

RELIANT ENERGY RESOURCES CORP.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2002

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PART I. FINANCIAL INFORMATION

RELIANT ENERGY RESOURCES CORP. AND SUBSIDIARIES
(A WHOLLY OWNED SUBSIDIARY OF RELIANT ENERGY, INCORPORATED)
STATEMENTS OF CONSOLIDATED OPERATIONS
(THOUSANDS OF DOLLARS)
(UNAUDITED)

| | THREE MONTHS ENDED JUNE 30, | | SIX MONTHS ENDED JUNE 30, | |
|---|---|---|---|---|
| | 2001 | 2002 | 2001 | 2002 |
| REVENUES | $ 959,998 | $ 868,471 | $ 3,382,851 | $ 2,110,750 |
| EXPENSES: | | | | |
| Natural gas | 712,925 | 583,526 | 2,704,448 | 1,445,105 |
| Operation and maintenance | 180,829 | 164,788 | 340,574 | 329,501 |
| Depreciation | 36,203 | 38,412 | 72,028 | 74,989 |
| Amortization | 15,417 | 3,569 | 30,813 | 7,263 |
| Taxes other than income taxes | 30,703 | 29,800 | 77,136 | 62,320 |
| Total | 976,077 | 820,095 | 3,224,999 | 1,919,178 |
| OPERATING (LOSS) INCOME | (16,079) | 48,376 | 157,852 | 191,572 |
| OTHER INCOME (EXPENSE): | | | | |
| Interest expense | (40,486) | (38,056) | (78,620) | (73,633) |
| Distribution on trust preferred securities | (7) | (7) | (14) | (13) |
| Other, net | 8,575 | 3,598 | 11,970 | 5,854 |
| Total | (31,918) | (34,465) | (66,664) | (67,792) |
| (LOSS) INCOME BEFORE INCOME TAXES | (47,997) | 13,911 | 91,188 | 123,780 |
| Income Tax (Benefit) Expense | (14,383) | 6,164 | 44,445 | 46,864 |
| NET (LOSS) INCOME | $ (33,614) | $ 7,747 | $ 46,743 | $ 76,916 |

See Notes to RERC's Interim Financial Statements

RELIANT ENERGY RESOURCES CORP. AND SUBSIDIARIES
(A WHOLLY OWNED SUBSIDIARY OF RELIANT ENERGY, INCORPORATED)
CONSOLIDATED BALANCE SHEETS
(THOUSANDS OF DOLLARS)
(UNAUDITED)

ASSETS

| | DECEMBER 31, 2001 | JUNE 30, 2002 |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 16,425 | $ 30,382 |
| Accounts and notes receivable, principally customers, net | 479,279 | 316,233 |
| Accrued unbilled revenue | 188,425 | 21,875 |
| Accounts and notes receivable - affiliated companies, net | 39,393 | 100,077 |
| Materials and supplies | 33,276 | 32,518 |
| Fuel and petroleum products | 111,193 | 72,612 |
| Non-trading derivative assets | 6,996 | 10,621 |
| Other | 17,932 | 10,279 |
| Total current assets | 892,919 | 594,597 |
| PROPERTY, PLANT AND EQUIPMENT: | | |
| Property, plant and equipment | 3,669,037 | 3,752,866 |
| Less accumulated depreciation | (521,960) | (573,695) |
| Property, plant and equipment, net | 3,147,077 | 3,179,171 |
| OTHER ASSETS: | | |
| Goodwill, net | 1,740,510 | 1,740,510 |
| Other intangibles, net | 17,980 | 18,987 |
| Prepaid pension asset | 94,022 | 87,716 |
| Non-trading derivative assets | 2,234 | 811 |
| Other | 94,221 | 56,953 |
| Total other assets | 1,948,967 | 1,904,977 |
| TOTAL ASSETS | $ 5,988,963 | $ 5,678,745 |

See Notes to RERC's Interim Financial Statements

RELIANT ENERGY RESOURCES CORP. AND SUBSIDIARIES
(A WHOLLY OWNED SUBSIDIARY OF RELIANT ENERGY, INCORPORATED)
CONSOLIDATED BALANCE SHEETS
(THOUSANDS OF DOLLARS) -- (CONTINUED)
(UNAUDITED)

LIABILITIES AND STOCKHOLDER'S EQUITY

| | DECEMBER 31, 2001 | JUNE 30, 2002 |
|---|---|---|
| CURRENT LIABILITIES: | | |
| Short-term borrowings | $ 345,527 | $ 147,671 |
| Accounts payable, principally trade | 267,649 | 267,353 |
| Interest accrued | 44,795 | 44,528 |
| Taxes accrued | 53,693 | 25,442 |
| Customer deposits | 52,089 | 49,738 |
| Non-trading derivative liabilities | 59,075 | 6,789 |
| Other | 95,180 | 55,629 |
| Total current liabilities | 918,008 | 597,150 |
| OTHER LIABILITIES: | | |
| Accumulated deferred income taxes, net | 555,387 | 491,198 |
| Benefit obligations | 177,559 | 172,185 |
| Non-trading derivative liabilities | 9,826 | 68 |
| Notes payable - affiliated companies, net | 27,311 | 27,340 |
| Other | 152,696 | 136,958 |
| Total other liabilities | 922,779 | 827,749 |
| LONG-TERM DEBT | 1,927,039 | 1,919,153 |
| COMMITMENTS AND CONTINGENCIES (NOTES 1 AND 11) | | |
| RERC OBLIGATED MANDATORILY REDEEMABLE CONVERTIBLE PREFERRED SECURITIES OF SUBSIDIARY TRUST HOLDING SOLELY JUNIOR SUBORDINATED DEBENTURES OF RERC | 555 | 555 |
| STOCKHOLDER'S EQUITY: | | |
| Common stock | 1 | 1 |
| Paid-in capital | 2,255,395 | 2,255,395 |
| Retained earnings | 1,837 | 78,753 |
| Accumulated other comprehensive loss | (36,651) | (11) |
| Total stockholder's equity | 2,220,582 | 2,334,138 |
| TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY | $ 5,988,963 | $ 5,678,745 |

See Notes to RERC's Interim Financial Statements

RELIANT ENERGY RESOURCES CORP. AND SUBSIDIARIES
(A WHOLLY OWNED SUBSIDIARY OF RELIANT ENERGY, INCORPORATED)
STATEMENTS OF CONSOLIDATED CASH FLOWS
(THOUSANDS OF DOLLARS)
(UNAUDITED)

| | SIX MONTHS ENDED JUNE 30, 2001 | SIX MONTHS ENDED JUNE 30, 2002 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | $ 46,743 | $ 76,916 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 102,841 | 82,252 |
| Deferred income taxes | (3,686) | (71,963) |
| Changes in other assets and liabilities: | | |
| Accounts and notes receivable, net | 650,994 | 329,596 |
| Accounts receivable/payable, affiliates | (55,179) | (79,064) |
| Inventory | (17,953) | 39,339 |
| Accounts payable | (417,708) | (296) |
| Fuel cost recovery | 43,818 | 32,030 |
| Interest and taxes accrued | (86,640) | (28,518) |
| Net non-trading derivative assets and liabilities | 815 | (52,979) |
| Other current assets | 16,245 | 7,807 |
| Other current liabilities | (29,178) | (41,386) |
| Other assets | (19,980) | 81 |
| Other liabilities | 15,722 | 11,365 |
| Other, net | 43,292 | -- |
| Net cash provided by operating activities | 290,146 | 305,180 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures | (125,224) | (117,991) |
| Other, net | (14,628) | 14,100 |
| Net cash used in investing activities | (139,852) | (103,891) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payments of long-term debt | (125,472) | (6,633) |
| Proceeds from long-term debt | 544,632 | -- |
| Decrease in short-term borrowings, net | (285,000) | (197,856) |
| (Decrease) increase in notes with affiliates, net | (130,567) | 18,410 |
| Dividend | (400,000) | -- |
| Capital contribution from Reliant Energy | 236,000 | -- |
| Other, net | (3,054) | (1,253) |
| Net cash used in financing activities | (163,461) | (187,332) |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (13,167) | 13,957 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD | 22,576 | 16,425 |
| CASH AND CASH EQUIVALENTS AT END OF THE PERIOD | $ 9,409 | $ 30,382 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash Payments: | | |
| Interest (net of amounts capitalized) | $ 70,922 | $ 73,719 |
| Income taxes | 114,071 | 153,360 |

See Notes to RERC's Interim Financial Statements

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

### (1) BASIS OF PRESENTATION

Included in this Quarterly Report on Form 10-Q (Form 10-Q) for Reliant Energy Resources Corp. (RERC Corp.), together with its subsidiaries (RERC), are RERC's consolidated interim financial statements and notes (Interim Financial Statements) including its wholly owned and majority owned subsidiaries. The Interim Financial Statements are unaudited, omit certain financial statement disclosures and should be read with the Amended Annual Report on Form 10-K/A of RERC Corp. (RERC Corp. Form 10-K/A) for the year ended December 31, 2001 which was filed with the Securities and Exchange Commission (SEC) on July 15, 2002 and the Quarterly Report on Form 10-Q of RERC Corp. for the quarter ended March 31, 2002.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

RERC's Interim Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to present fairly the financial position and results of operations for the respective periods. Amounts reported in RERC's Statements of Consolidated Operations are not necessarily indicative of amounts expected for a full year period due to the effects of, among other things, (a) seasonal variations in energy consumption, (b) timing of maintenance and other expenditures and (c) acquisitions and dispositions of assets and other interests. In addition, certain amounts from the prior year have been reclassified to conform to RERC's presentation of financial statements in the current year. These reclassifications do not affect earnings of RERC.

The following notes to the consolidated financial statements in the RERC Corp. Form 10-K/A relate to certain contingencies. These notes, as updated herein, are incorporated herein by reference:

Notes to Consolidated Financial Statements (RERC Corp. 10-K/A Notes): Note 3(f) (Regulatory Assets), Note 5 (Derivative Instruments) and Note 10 (Commitments and Contingencies).

For information regarding environmental matters and legal proceedings, see Note 11.

### (2) NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141 "Business Combinations" (SFAS No. 141). SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles will be evaluated against these new criteria and may result in certain intangibles being transferred to goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. RERC adopted the provisions of the statement which apply to goodwill and intangible assets acquired prior to June 30, 2001 on January 1, 2002. The adoption of SFAS No. 141 did not have a material impact on RERC's historical results of operations or financial position.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144). SFAS No. 144 provides new guidance on the recognition of impairment losses on long-lived assets to be held and used or to be disposed of and also broadens the definition of what constitutes a discontinued operation and how the results of a discontinued operation are to be measured and presented. SFAS No. 144 supercedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," while retaining many of the requirements of these two statements. Under SFAS No. 144, assets held for sale that are a component of an entity will be included in discontinued operations if the operations and cash flows will be or have been eliminated from the ongoing operations of the entity and the entity will not have any significant continuing involvement in the operations prospectively. SFAS No. 144 did not materially change the methods used by RERC to measure impairment losses on long-lived assets, but may result in additional future dispositions being reported as discontinued operations than was previously permitted. RERC adopted SFAS No. 144 on January 1, 2002.

See Note 3 for a discussion of RERC's adoption of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended (SFAS No. 133), on January 1, 2001. See Note 6 for a discussion of RERC's adoption of SFAS No. 142 "Goodwill and Other Intangible Assets" (SFAS No. 142) on January 1, 2002.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections" (SFAS No. 145). SFAS No. 145 eliminates the current requirement that gains and losses on debt extinguishment must be classified as extraordinary items in the income statement. Instead, such gains and losses will be classified as extraordinary items only if they are deemed to be unusual and infrequent. SFAS No. 145 also requires that capital leases that are modified so that the resulting lease agreement is classified as an operating lease be accounted for as a sale-leaseback transaction. The changes related to debt extinguishment will be effective for fiscal years beginning after May 15, 2002, and the changes related to lease accounting will be effective for transactions occurring after May 15, 2002. RERC will apply this guidance prospectively.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS No. 146). SFAS No. 146 nullifies EITF No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" (EITF No. 94-3). The principal difference between SFAS No. 146 and EITF No. 94-3 relates to the requirements for recognition of a liability for cost associated with an exit or disposal activity. SFAS No. 146 requires that a liability be recognized for a cost associated with an exit or disposal activity when it is incurred. A liability is incurred when a transaction or event occurs that leaves an entity little or no discretion to avoid the future transfer or use of assets to settle the liability. Under EITF No. 94-3, a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. In addition, SFAS No. 146 also requires that a liability for a cost associated with an exit or disposal activity be recognized at its fair value when it is incurred. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002 with early application encouraged. RERC will apply the provisions of SFAS No. 146 to all exit or disposal activities initiated after December 31, 2002

(3) DERIVATIVE INSTRUMENTS

Adoption of SFAS No. 133 on January 1, 2001 resulted in a cumulative after-tax increase in accumulated other comprehensive income of $38 million.

Cash Flow Hedges. During the six months ended June 30, 2002, there was no hedge ineffectiveness recognized in earnings from derivatives that are designated and qualify as cash flow hedges. No component of the derivative instruments' gain or loss was excluded from the assessment of effectiveness. During the six months ended June 30, 2002, a $0.9 million deferred loss was recognized in earnings as a result of the discontinuance of a cash flow hedge because it was no longer probable that the forecasted transaction would occur due to credit problems of a customer. As of June 30, 2002, RERC expects a gain of $4 million in accumulated other comprehensive income to be reclassified into net income during the next twelve months.

(4) RELIANT ENERGY'S SEPARATION PLAN

Reliant Energy, Incorporated (Reliant Energy) is in the process of separating its regulated and unregulated businesses into two publicly traded companies that will be independent of each other: CenterPoint Energy, Inc. (CenterPoint Energy) and Reliant Resources, Inc (Reliant Resources). In December 2000, Reliant Energy transferred a significant portion of its unregulated businesses, including certain businesses that had been subsidiaries of RERC, to Reliant Resources, which, at the time, was a wholly owned subsidiary of Reliant Energy. Reliant Resources conducted an initial public offering of approximately 20% of its common stock in May 2001. In December 2001, Reliant Energy's shareholders approved an agreement and plan of merger by which, subject to regulatory approvals, the following will occur (which is referred to herein as the Restructuring):

- o CenterPoint Energy will become the holding company for the Reliant Energy group of companies;

- o Reliant Energy and its subsidiaries will become subsidiaries of CenterPoint Energy; and

- o each share of Reliant Energy common stock will be converted into one share of CenterPoint Energy common stock.

After the Restructuring, Reliant Energy plans, subject to further corporate approvals, market and other conditions, to complete the separation of its regulated and unregulated businesses by distributing the shares of common stock of Reliant Resources that CenterPoint Energy owns to the CenterPoint Energy's shareholders (which is referred to herein as the Distribution). RERC currently expects Reliant Energy to complete the Restructuring by August 31, 2002 and the Distribution early in the fall of 2002. However, no assurance can be provided that the Distribution will occur as described above or that it will occur within this time period. From the consummation of the Restructuring until the Distribution, RERC expects that CenterPoint Energy will do business under the name Reliant Energy, Incorporated and that CenterPoint Energy's common stock will trade under the symbol "REI."

On July 5, 2002, Reliant Energy received an order from the SEC approving Reliant Energy's restructuring plan and the Distribution under the Public Utility Holding Company Act of 1935 (1935 Act). On July 31, 2002, Reliant Energy received a private letter ruling from the Internal Revenue Service which confirms that the Distribution will be tax-free to Reliant Energy and its shareholders.

Contemporaneous with the Restructuring, RERC expects CenterPoint Energy to register and become subject, with its subsidiaries, to regulation as a registered holding company system under the 1935 Act. The 1935 Act directs the SEC to regulate, among other things, financings, sales or acquisitions of assets and intra-system transactions.

In connection with the Restructuring, in order to enable CenterPoint Energy ultimately to satisfy the requirements for an exemption from regulation as a registered holding company under the 1935 Act, Reliant Energy is seeking authority to divide the gas distribution businesses conducted by RERC Corp.'s three unincorporated gas distribution divisions, Reliant Energy Entex, Reliant Energy Arkla and Reliant Energy Minnegasco, among three separate entities. The entity that will hold the Reliant Energy Entex assets will also hold ownership of RERC Corp.'s natural gas pipelines and gathering business. Reliant Energy has obtained approval of these transactions from the public service commissions of Minnesota, Louisiana, Mississippi, Oklahoma and Arkansas. Although RERC Corp. expects that this business restructuring of RERC Corp. can be completed, RERC Corp. can provide no assurance that this will, in fact, occur, or that CenterPoint Energy will ultimately be exempt from registration under the 1935 Act. For further information on the RERC Corp. restructuring, see "Our Business in Item 1 of the RERC Corp. Form 10-K/A.

(5) REGULATORY MATTERS

(a) Arkla Rate Case.

In November 2001, Reliant Energy Arkla filed a rate request in Arkansas seeking rates to yield approximately $47 million in additional annual revenue. On August 9, 2002, a settlement was approved by the Arkansas Public Service Commission (APSC) which will result in an increase in base rates of approximately $32 million annually. In addition, the APSC approved a gas main replacement surcharge which is expected to provide $2 million in 2003 and additional amounts in subsequent years. The settlement provides for a new residential rate design which increases the monthly customer charge. The new rates are expected to be effective September 21, 2002.

(b) Oklahoma Rate Case.

In May 2002, Reliant Energy Arkla filed a rate change request for an increase in rates that would yield approximately $13.7 million annually in Oklahoma. A decision on this request is expected from the Oklahoma Corporation Commission no later than early 2003.

(c) City of Tyler, Texas Hearing on Gas Costs.

By letter to Reliant Energy Entex dated July 31, 2002, the City of Tyler, Texas expressed "serious concerns" regarding amounts that Entex has paid for gas purchased for resale to residential and small commercial customers in that city under supply agreements in effect since 1992. Entex's gas costs for its Tyler system are recovered from customers pursuant to tariffs approved by the city and filed with both the city and the Railroad Commission of Texas. In the July 31, letter, the city forwarded various computations of what it believes to be excessive costs ranging from approximately $2.8 million to $39.2 million. The City has called a hearing for September 25, 2002 to consider these issues. The Company believes (i) that all gas costs for Entex's Tyler distribution system have been properly included and recovered from customers pursuant to Entex's filed tariffs (ii) that the City has no legal or factual support for the statements made in its letter and (iii) that the city has no authority to require or demand refunds of any amounts Entex has charged its customers in the City of Tyler.

(6) GOODWILL AND INTANGIBLES

In July 2001, the FASB issued SFAS No. 142, which provides for a nonamortization approach, whereby goodwill and certain intangibles with indefinite lives will not be amortized into results of operations, but instead will be reviewed periodically for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles with indefinite lives is more than its fair value. RERC adopted the provisions of the statement which apply to goodwill and intangible assets acquired prior to June 30, 2001 on January 1, 2002.

With the adoption of SFAS No. 142, RERC ceased amortization of goodwill as of January 1, 2002. A reconciliation of previously reported net income to the amounts adjusted for the exclusion of goodwill amortization follows:

| | THREE MONTHS ENDED JUNE 30, | | SIX MONTHS ENDED JUNE 30, | |
|---|---|---|---|---|
| | 2001 | 2002 | 2001 | 2002 |
| | (IN MILLIONS) | | | |
| Reported net (loss) income .............................. | $(34) | $ 8 | $ 47 | $ 77 |
| Add: Goodwill amortization, net of tax .................. | 12 | -- | 24 | -- |
| Adjusted net (loss) income .............................. | $(22) | $ 8 | $ 71 | $ 77 |

The components of RERC's other intangible assets consist of the following:

| | DECEMBER 31, 2001 | | JUNE 30, 2002 | |
|---|---|---|---|---|
| | CARRYING AMOUNT | ACCUMULATED AMORTIZATION | CARRYING AMOUNT | ACCUMULATED AMORTIZATION |
| | (IN MILLIONS) | | | |
| Land Use Rights ......................................... | $ 7 | $ (2) | $ 7 | $ (2) |
| Other ................................................... | 15 | (2) | 16 | (2) |
| Total ................................................... | $ 22 | $ (4) | $ 23 | $ (4) |

RERC recognizes specifically identifiable intangibles when specific rights and contracts are acquired. RERC amortizes other acquired intangibles on a straight-line basis over the lesser of their contractual or estimated useful lives. RERC has no intangible assets with indefinite lives recorded as of June 30, 2002.

Amortization expense for other intangibles for the three and six months ended June 30, 2001 was $0.1 million and $0.3 million, respectively. Amortization expense for other intangibles for the three and six months ended June 30, 2002 was $0.2 million and $0.5 million, respectively. Estimated amortization expense for the remainder of 2002 is approximately $0.6 million and is approximately $1 million per year for the five succeeding fiscal years.

Goodwill as of June 30, 2002 by reportable business segment is as follows (in millions):

| | AS OF JUNE 30, 2002 |
|---|---|
| Natural Gas Distribution....... | $1,085 |
| Pipelines and Gathering........ | 601 |
| Other Operations............... | 54 |
| Total........................ | $1,740 |

As of June 30, 2002 RERC has completed its review of goodwill impairment for its reporting units pursuant to SFAS No. 142. No impairment was indicated as a result of this assessment.

(7) SHORT-TERM BORROWINGS

RERC Corp. has a receivables facility under which it sells certain of its and its subsidiaries' customer accounts receivable. Advances under this facility are reflected in the Consolidated Balance Sheets as short-term debt. In the first quarter of 2002, RERC Corp. reduced its trade receivables facility from $350 million to $150 million. Borrowings under the receivables facility aggregating $196 million were repaid in January 2002 with proceeds from the issuance of commercial paper under RERC Corp.'s $350 million revolving credit facility and from the liquidation of short-term investments. The $150 million RERC Corp. receivables facility was scheduled to expire on August 14, 2002. RERC Corp. has extended the facility to October 31, 2002, during which time RERC Corp. expects to negotiate a new receivables facility with the financial institution that provides the current facility. At June 30, 2002, RERC Corp. had $2.5 million of letters of credit outstanding under the revolving credit facility. RERC had no commercial paper or bank loans outstanding at June 30, 2002. RERC expects to evaluate various alternatives for renewing or replacing this bank facility prior to its scheduled expiration date of March 31, 2003.

(8) TRUST PREFERRED SECURITIES

A statutory business trust created by RERC Corp. (RERC Trust) has issued convertible trust preferred securities, the terms of which, and the related series of convertible junior subordinated debentures, are described below (in millions):

| | AGGREGATE LIQUIDATION AMOUNT | | | | |
|---|---|---|---|---|---|
| TRUST | DECEMBER 31, 2001 | JUNE 30, 2002 | DISTRIBUTION RATE/ INTEREST RATE | MANDATORY REDEMPTION DATE/ MATURITY DATE | JUNIOR SUBORDINATED DEBENTURES |
| RERC Trust | $ 1 | $ 1 | 6.25% | June 2026 | 6.25% Convertible Junior Subordinated Debentures due 2026 |

For additional information regarding the convertible preferred securities, see Note 7 to the RERC Corp. 10-K/A Notes, which is incorporated herein by reference. The sole asset of the trust consists of convertible junior subordinated debentures of RERC Corp. having an interest rate and maturity date that correspond to the distribution rate and mandatory redemption date of the convertible preferred securities, and a principal amount corresponding to the common and convertible preferred securities issued by the trust.

(9) COMPREHENSIVE INCOME

The following table summarizes the components of total comprehensive income:

| | FOR THE THREE MONTHS ENDED JUNE 30, | | FOR THE SIX MONTHS ENDED JUNE 30, | |
|---|---|---|---|---|
| | 2001 | 2002 | 2001 | 2002 |
| | (IN MILLIONS) | | | |
| Net (loss) income | $(34) | $ 8 | $ 47 | $ 77 |
| Other comprehensive (loss) income: | | | | |
| Additional minimum non-qualified pension liability adjustment | 3 | -- | 4 | -- |
| Cumulative effect of adoption of SFAS No. 133 | -- | -- | 38 | -- |
| Net deferred (loss) gain from cash flow hedges | (50) | (10) | (60) | 36 |
| Reclassification of deferred (gain) loss on derivatives realized in net income | (1) | (3) | (14) | 1 |
| Other comprehensive (loss) income | (48) | (13) | (32) | 37 |
| Comprehensive (loss) income | $(82) | $ (5) | $ 15 | $114 |

(10) RELATED PARTY TRANSACTIONS

From time to time, RERC has advanced money to, or borrowed money from, Reliant Energy or its subsidiaries. As of December 31, 2001 and June 30, 2002, RERC had net short-term receivables, included in accounts and notes receivable-affiliated companies, totaling $132 million and $114 million, respectively, partially offset by net accounts payable of $93 million and $14 million, respectively. As of December 31, 2001 and June 30, 2002, RERC had net long-term borrowings, included in notes payable-affiliated companies, totaling $27 million. For the three and six months ended June 30, 2001, RERC had net interest income of $3 million and $5 million, respectively. For the three and six months ended June 30, 2002, RERC had net interest income of $0.4 million and $0.3 million, respectively.

In 2001 and 2002, RERC supplied natural gas to Reliant Energy Services, Inc. (RES), now a subsidiary of Reliant Resources. For the three and six months ended June 30, 2001, the sales and services by RERC to Reliant Energy and its affiliates totaled $54 million and $133 million, respectively. For the three and six months ended June 30, 2002, the sales and services by RERC to Reliant Energy and its affiliates totaled $28 million and $42 million, respectively. Purchases by RERC of natural gas from Reliant Energy and its affiliates were $129 million and $431 million for the three and six months ended June 30, 2001, respectively, and $51 million and $158 million for the three and six months ended June 30, 2002, respectively.

Reliant Energy provides some corporate services to RERC, including various corporate support services (including accounting, finance, investor relations, planning, legal, communications, governmental and regulatory affairs and human resources), information technology services and other shared services such as corporate security, facilities management, accounts receivable, accounts payable, payroll, office support services, customer care services and purchasing and logistics. The costs of services have been directly charged or allocated to RERC using methods that management believes are reasonable. These methods include negotiated usage rates, dedicated asset assignment, and proportionate corporate formulas based on assets, operating expenses and employees. These charges and allocations are not necessarily indicative of what would have been incurred had RERC been a separate entity. Amounts charged and allocated to RERC for these services were $21 million and $38 million for the three and six months ended June 30, 2001, respectively, and $25 million and $51 million for the three and six months ended June 30, 2002, respectively, and are included primarily in operation and maintenance expenses. Rent expense paid by RERC to Reliant Energy for the three and six months ended June 30, 2001 was $0.4 million and $0.8 million, respectively, and $1.0 million and $1.9 million for the three and six months ended June 30, 2002, respectively.

(11) ENVIRONMENTAL MATTERS AND LEGAL PROCEEDINGS

(a) Environmental Matters.

Hydrocarbon Contamination. On August 24, 2001, 37 plaintiffs filed suit against Reliant Energy Gas Transmission Company, Inc. (REGT), Reliant Energy Pipeline Services, Inc., RERC, RES, other Reliant Energy entities and third parties (Docket No. 460, 916-Div. "B"), in the 1st Judicial District Court, Caddo Parish, Louisiana. The petition has now been supplemented five times. As of July 29, 2002, there were 649 plaintiffs, a majority of whom are Louisiana residents. In addition to the Reliant Energy entities, the plaintiffs have sued the State of Louisiana through its Department of Environmental Quality, several individuals, some of whom are present employees of the State of Louisiana, the Bayou South Gas Gathering Company, L.L.C., Martin Timber Company, Inc., and several trusts. Additionally on April 4, 2002, two plaintiffs filed a separate suit with identical allegations against the same parties (Docket No. 465, 944-Div. "B") in the same court.

The suits allege that, at some unspecified date prior to 1985, the defendants allowed or caused hydrocarbon or chemical contamination of the Wilcox Aquifer which lies beneath property owned or leased by certain of the defendants and which is the sole or primary drinking water aquifer in the area. The primary source of the contamination is alleged by the plaintiffs to be a gas processing facility in Haughton, Bossier Parish, Louisiana known as the "Sligo Facility." This facility was purportedly used for gathering natural gas from surrounding wells, separating gasoline and hydrocarbons from the natural gas for marketing, and transmission of natural gas for distribution. This site was originally leased and operated by predecessors of REGT in the late 1940s and was operated until Arkansas Louisiana Gas Company ceased operations of the plant in the late 1970s.

Beginning about 1985, the predecessors of certain Reliant Energy defendants engaged in a voluntary remediation of any subsurface contamination of the groundwater below the property they own or lease. This work has been done in conjunction with and under the direction of the Louisiana Department of Environmental Quality. The plaintiffs seek monetary damages for alleged damage to the aquifer underlying their property, unspecified alleged personal injuries, alleged fear of cancer, alleged property damage or dimunition of value of their property, and, in addition, seek damages for trespass, punitive, and exemplary damages. The quantity of monetary damages sought is unspecified. As of June 30, 2002, RERC is unable to estimate the monetary damages, if any, that the plaintiffs may be awarded in these matters.

Manufactured Gas Plant Sites. RERC and its predecessors operated a manufactured gas plant (MGP) until 1960 adjacent to the Mississippi River in Minnesota, formerly known as Minneapolis Gas Works (MGW). RERC has substantially completed remediation of the main site other than ongoing water monitoring and treatment. The manufactured gas was stored in separate holders. RERC is negotiating clean-up of one such holder. There are six other former MGP sites in the Minnesota service territory. Remediation has been completed on one site. Of the remaining five sites, RERC believes that two were neither owned nor operated by RERC. RERC believes it has no liability with respect to the sites it neither owned nor operated.

At June 30, 2002, RERC had accrued $23 million for remediation of the Minnesota sites. At June 30, 2002, the estimated range of possible remediation costs was $11 million to $49 million. The cost estimates of the MGW site are based on studies of that site. The remediation costs for the other sites are based on industry average costs for remediation of sites of similar size. The actual remediation costs will be dependent upon the number of sites remediated, the participation of other potentially responsible parties (PRP), if any, and the remediation methods used.

Issues relating to the identification and remediation of MGPs are common in the natural gas distribution industry. RERC has received notices from the United States Environmental Protection Agency and others regarding its status as a PRP for other sites. Based on current information, RERC has not been able to quantify a range of environmental expenditures for potential remediation expenditures with respect to other MGP sites.

Other Minnesota Matters. At June 30, 2002, RERC had recorded accruals of $5 million for other environmental matters in Minnesota for which remediation may be required. At June 30, 2002, the estimated range of possible remediation costs was $4 million to $8 million.

Mercury Contamination. RERC's pipeline and distribution operations have in the past employed elemental mercury in measuring and regulating equipment. It is possible that small amounts of mercury may have been spilled in the course of normal maintenance and replacement operations and that these spills may have contaminated the immediate area with elemental mercury. This type of contamination has been found by RERC at some sites in the past, and RERC has conducted remediation at these sites. It is possible that other contaminated sites may exist and that remediation costs may be incurred for these sites. Although the total amount of these costs cannot be known at this time, based on experience by RERC and that of others in the natural gas industry to date and on the current regulations regarding remediation of these sites, RERC believes that the costs of any remediation of these sites will not be material to RERC's financial position, results of operations or cash flows.

Potentially Responsible Party Notifications. From time to time RERC has received notices from regulatory authorities or others regarding its status as a PRP in connection with sites found to require remediation due to the presence of environmental contaminants. Considering the information currently known about such sites and the involvement of RERC in activities at these sites, RERC does not believe that these matters will have a material adverse effect on RERC's financial position, results of operations or cash flows.

(b) Other Legal Matters.

Natural Gas Measurement Lawsuits. In 1997, a suit was filed under the Federal False Claim Act against RERC, REGT and Reliant Energy Field Services, Inc. (REFS) alleging mismeasurement of natural gas produced from federal and Indian lands. The suit seeks undisclosed damages, along with statutory penalties, interest, costs, and fees. The complaint is part of a larger series of complaints filed against 77 natural gas pipelines and their subsidiaries and affiliates. An earlier single action making substantially similar allegations against the pipelines was dismissed by the U.S. District Court for the District of Columbia on grounds of improper joinder and lack of jurisdiction. As a result, the various individual complaints were filed in numerous courts throughout the country. This case was consolidated, together with the other similar False Claim Act cases filed and transferred to the District of Wyoming. Motions to dismiss were denied. The defendants intend to vigorously contest this case.

In addition, RERC, REGT, REFS and Mississippi River Transmission Corporation (MRT) have been named as defendants in a class action filed in May 1999 against approximately 245 pipeline companies and their affiliates. The plaintiffs in the case purport to represent a class of natural gas producers and fee royalty owners who allege that they have been subject to systematic gas mismeasurement by the defendants, including certain Reliant Energy entities, for more than 25 years. The plaintiffs seek compensatory damages, along with statutory penalties, treble damages, interest, costs and fees. The action is currently pending in state court in Stevens County, Kansas. Plaintiffs initially sued RES, but that company was dismissed without prejudice on June 8, 2001. Other Reliant Energy entities that were misnamed or duplicative have also been dismissed. MRT and REFS have filed motions to dismiss for lack of personal jurisdiction and are currently responding to discovery on personal jurisdiction. All of the defendants have joined in a motion to dismiss.

The defendants plan to raise significant affirmative defenses based on the terms of the applicable contracts, as well as on the broad waivers and releases in take or pay settlements that were granted by the producer-sellers of natural gas who are putative class members.

Other. RERC is a party to litigation (other than that specifically noted) which arises in the normal course of business. Management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. Management believes that the effects, if any, from the disposition of these matters will not have a material adverse effect on RERC's financial position, results of operations or cash flows.

(12) REPORTABLE BUSINESS SEGMENTS

Because RERC Corp. is a wholly owned subsidiary of Reliant Energy, RERC's determination of reportable business segments considers the strategic operating units under which Reliant Energy manages sales, allocates resources and assesses performance of various products and services to wholesale or retail customers in differing regulatory environments.

RERC's reportable business segments include the following: Natural Gas Distribution, Pipelines and Gathering and Other Operations. For descriptions of the reportable business segments, see Note 13 to the RERC Corp. 10-K Notes, which is incorporated herein by reference.

Beginning in the first quarter of 2002, RERC began to evaluate performance on an earnings (loss) before interest expense, interest income and income taxes (EBIT) basis. Prior to 2002, RERC evaluated performance on operating income. EBIT, as defined, is shown because it is a widely accepted measure of financial performance used by analysts and investors to analyze and compare companies on the basis of operating performance. EBIT is not defined under accounting principles generally accepted in the United States (GAAP), and should not be considered in isolation or as a substitute for a measure of performance prepared in accordance with GAAP and is not indicative of operating income from operations as determined under GAAP. Reportable business segments from previous years have been restated to conform to the 2002 presentation. Additionally, RERC's computation of EBIT may not be comparable to other similarly titled measures computed by other companies, because all companies do not calculate it in the same fashion.

The following table summarizes financial data for the reportable business segments:

| | FOR THE THREE MONTHS ENDED JUNE 30, 2001 | | |
|---|---|---|---|
| | REVENUES FROM THIRD PARTIES AND NON-RERC AFFILIATES | NET INTERSEGMENT REVENUES | EBIT |
| | | (IN MILLIONS) | |
| Natural Gas Distribution .......... | $ 856 | $ 32 | $ (41) |
| Pipelines and Gathering ........... | 50 | 46 | 34 |
| Other Operations .................. | -- | -- | -- |
| Reconciling Eliminations .......... | -- | (78) | (1) |
| Sales to Non-RERC Affiliates ...... | 54 | -- | -- |
| Consolidated ...................... | $ 960 | $ -- | $ (8) |

| | FOR THE THREE MONTHS ENDED JUNE 30, 2002 | | |
|---|---|---|---|
| | REVENUES FROM THIRD PARTIES AND NON-RERC AFFILIATES | NET INTERSEGMENT REVENUES | EBIT |
| | | (IN MILLIONS) | |
| Natural Gas Distribution .................... | $ 779 | $ 18 | $ 14 |
| Pipelines and Gathering ..................... | 61 | 41 | 41 |
| Other Operations ............................ | -- | -- | (3) |
| Reconciling Elimination ..................... | -- | (59) | -- |
| Sales to Non-RERC Affiliates ................ | 28 | -- | -- |
| Consolidated ................................ | $ 868 | $ -- | $ 52 |

| | FOR THE SIX MONTHS ENDED JUNE 30, 2001 | | | AS OF DECEMBER 31, 2001 |
|---|---|---|---|---|
| | REVENUES FROM THIRD PARTIES AND NON-RERC AFFILIATES | NET INTERSEGMENT REVENUES | EBIT | TOTAL ASSETS |
| | | (IN MILLIONS) | | |
| Natural Gas Distribution .................... | $3,125 | $ 86 | $ 96 | $ 3,732 |
| Pipelines and Gathering ..................... | 125 | 101 | 73 | 2,361 |
| Other Operations ............................ | -- | -- | 1 | 495 |
| Reconciling Eliminations .................... | -- | (187) | -- | (599) |
| Sales to Non-RERC Affiliates ................ | 133 | -- | -- | -- |
| Consolidated ................................ | $3,383 | $ -- | $ 170 | $ 5,989 |

| | FOR THE SIX MONTHS ENDED JUNE 30, 2002 | | | AS OF JUNE 30, 2002 |
|---|---|---|---|---|
| | REVENUES FROM THIRD PARTIES AND NON-RERC AFFILIATES | NET INTERSEGMENT REVENUES | EBIT | TOTAL ASSETS |
| | | (IN MILLIONS) | | |
| Natural Gas Distribution .................... | $1,957 | $ 20 | $ 124 | $ 3,476 |
| Pipelines and Gathering ..................... | 112 | 82 | 79 | 2,371 |
| Other Operations ............................ | -- | -- | (2) | 152 |
| Reconciling Elimination ..................... | -- | (102) | (3) | (320) |
| Sales to Non-RERC Affiliates ................ | 42 | -- | -- | -- |
| Consolidated ................................ | $2,111 | $ -- | $ 198 | $ 5,679 |

Reconciliation of Operating Income to EBIT and EBIT to Net Income:

| | FOR THE THREE MONTHS ENDED JUNE 30, | | FOR THE SIX MONTHS ENDED JUNE 30, | |
|---|---|---|---|---|
| | 2001 | 2002 | 2001 | 2002 |
| | | (IN MILLIONS) | | |
| Operating (Loss) Income ............................ | $ (16) | $ 48 | $ 158 | $ 192 |
| Other Income, net .................................. | 8 | 4 | 12 | 6 |
| Earnings (Loss) Before Interest and ................ | 170 | 198 | | |
| Taxes .............................................. | (8) | 52 | | |
| Interest Expense ................................... | (40) | (38) | (79) | (74) |
| (Loss) Income Before Income Taxes .................. | (48) | 14 | 91 | 124 |
| Income Tax (Benefit) Expense ....................... | (14) | 6 | 44 | 47 |
| Net (Loss) Income .................................. | $ (34) | $ 8 | $ 47 | $ 77 |

## MANAGEMENT'S NARRATIVE ANALYSIS OF THE RESULTS OF OPERATIONS OF RELIANT ENERGY RESOURCES CORP. AND SUBSIDIARIES

The following narrative analysis should be read in combination with RERC Corp.'s Interim Financial Statements and notes contained in this Form 10-Q.

Reliant Energy, Incorporated (Reliant Energy) is in the process of separating its regulated and unregulated businesses into two publicly traded companies that will be independent of each other: CenterPoint Energy, Inc. (CenterPoint Energy) and Reliant Resources, Inc. (Reliant Resources). In December 2000, Reliant Energy transferred a significant portion of its unregulated businesses to Reliant Resources, which, at the time, was a wholly owned subsidiary of Reliant Energy. Reliant Resources conducted an initial public offering of approximately 20% of its common stock in May 2001. In December 2001, Reliant Energy's shareholders approved an agreement and plan of merger by which, subject to regulatory approvals, the following will occur (which we refer to herein as the Restructuring):

- CenterPoint Energy will become the holding company for the Reliant Energy group of companies;

- Reliant Energy and its subsidiaries will become subsidiaries of CenterPoint Energy; and

- each share of Reliant Energy common stock will be converted into one share of CenterPoint Energy common stock.

After the Restructuring, Reliant Energy plans, subject to further corporate approvals, market and other conditions, to complete the separation of its regulated and unregulated businesses by distributing the shares of common stock of Reliant Resources that CenterPoint Energy owns to the CenterPoint Energy's shareholders (which we refer to herein as the Distribution). Reliant Energy's goal is to complete the Restructuring and subsequent Distribution as quickly as possible. RERC currently expects Reliant Energy to complete the Restructuring by August 31, 2002 and the Distribution early in the fall of 2002. However, no assurance can be provided that the Distribution will occur as described above or that it will occur within this time period. From the consummation of the Restructuring until the Distribution, RERC expects that CenterPoint Energy will do business under the name Reliant Energy, Incorporated and that CenterPoint Energy's common stock will trade under the symbol "REI."

On July 5, 2002, Reliant Energy received an order from the Securities and Exchange Commission (SEC) approving Reliant Energy's restructuring plan and the Distribution under the Public Utility Holding Company Act of 1935 (1935 Act). On July 31, 2002, Reliant Energy received a private letter ruling from the Internal Revenue Service which confirms that the Distribution will be tax-free to Reliant Energy and its shareholders.

Contemporaneous with the Restructuring, RERC expects CenterPoint Energy to register and become subject, with its subsidiaries, to regulation as a registered holding company system under the 1935 Act. The 1935 Act directs the SEC to regulate, among other things, financings, sales or acquisitions of assets and intra-system transactions.

In connection with the Restructuring, in order to enable CenterPoint Energy ultimately to satisfy the requirements for an exemption from regulation as a registered holding company under the 1935 Act, Reliant Energy is seeking authority to divide the gas distribution businesses conducted by RERC Corp.'s three unincorporated gas distribution divisions, Reliant Energy Entex, Reliant Energy Arkla and Reliant Energy Minnegasco, among three separate entities. The entity that will hold the Reliant Energy Entex assets will also hold ownership of RERC Corp.'s natural gas pipelines and gathering business. Reliant Energy has obtained approval of these transactions from the public service commissions of Minnesota, Louisiana, Mississippi, Oklahoma and Arkansas. Although RERC Corp. expects that this business restructuring of RERC Corp. can be completed, RERC Corp. can provide no assurance that this will, in fact, occur, or that CenterPoint Energy will ultimately be exempt from registration under the 1935 Act. For further information on the RERC Corp. restructuring, see "Our Business in Item 1 of the RERC Corp. Form 10-K/A.

RERC Corp. meets the conditions specified in General Instruction H(1)(a) and (b) to Form 10-Q and is therefore permitted to use the reduced disclosure format for wholly owned subsidiaries of reporting companies. Accordingly, RERC Corp. has omitted from this report the information called for by Item 3 (Quantitative and

Qualitative Disclosures About Market Risk) of Part I and the following Part II items of Form 10-Q: Item 2 (Changes in Securities and Use of Proceeds), Item 3 (Defaults Upon Senior Securities) and Item 4 (Submission of Matters to a Vote of Security Holders). The following discussion explains material changes in the amount of revenue and expense items of RERC between the three months and six months ended June 30, 2002 and the three months and six months ended June 30, 2001. Reference is made to Management's Narrative Analysis of the Results of Operations of Reliant Energy Resources Corp. and its Subsidiaries in Item 7 of the RERC Corp. Form 10-K/A.

CONSOLIDATED RESULTS OF OPERATIONS

| | THREE MONTHS ENDED JUNE 30, | | SIX MONTHS ENDED JUNE 30, | |
|---|---|---|---|---|
| | 2001 | 2002 | 2001 | 2002 |
| | (IN MILLIONS) | | | |
| Operating Revenues | $ 960 | $ 868 | $ 3,383 | $ 2,111 |
| Operating Expenses | (976) | (820) | (3,225) | (1,919) |
| Operating (Loss) Income, net | (16) | 48 | 158 | 192 |
| Other Income, net | 8 | 4 | 12 | 6 |
| Earnings (Loss) Before Interest and Taxes | (8) | 52 | 170 | 198 |
| Interest Expense | (40) | (38) | (79) | (74) |
| Income (Loss) Before Income Taxes | (48) | 14 | 91 | 124 |
| Income Tax (Benefit) Expense | (14) | 6 | 44 | 47 |
| Net (Loss) Income | $ (34) | $ 8 | $ 47 | $ 77 |

For the second quarter of 2002, RERC's net income was $8 million compared to a net loss of $34 million for the same period in 2001. The $42 million increase was primarily due to:

- a significant reduction in bad debt expense in the Natural Gas Distribution business segment as a result of improved collections and lower gas prices in 2002. Higher gas prices and increased usage due to colder weather in 2001 negatively impacted collections and resulted in an increase in bad debt expense in 2001;

- decreased amortization expense of approximately $12 million as a result of the discontinuance of goodwill amortization in accordance with Statement of Financial Accounting Standards No. 142, "Accounting for Goodwill and Intangible Assets" (SFAS No. 142); and

- changes in estimates of unbilled revenues and deferred gas costs, which negatively impacted the second quarter of 2001.

For the first six months of 2002, RERC's net income was $77 million compared to net income of $47 million for the same period in 2001. The $30 million increase was primarily due to:

- a significant reduction in bad debt expense in the Natural Gas Distribution business segment as discussed above;

- decreased amortization expense of approximately $24 million as a result of the discontinuance of goodwill amortization in accordance with SFAS No. 142 as discussed above; and

- changes in estimates of unbilled revenues and deferred gas costs in 2001 as discussed above.

The above items were partially offset by significantly milder weather, decreased usage and increased project work expenses for construction management, engineering, project planning and other services during the second quarter and first six months of 2002 compared to 2001.

RERC's operating revenues for the quarter and six months ended June 30, 2002, were $0.9 billion and $2.1 billion, respectively, compared to $1.0 billion and $3.4 billion, respectively, for the same periods in 2001. The decrease for both periods was primarily due to significantly milder weather, decreased usage and lower gas prices in 2002 compared to 2001.

RERC's operating expenses for the quarter and six months ended June 30, 2002, were $0.8 billion and $1.9 billion, respectively, compared to $1.0 billion and $3.2 billion, respectively, for the same periods in 2001. These decreases were primarily due to the same reasons for the decreases in revenues discussed above.

RERC's effective tax rate for the three months ended June 30, 2001 and 2002 was 30% and 44%, respectively. RERC reported a pretax loss for the second quarter of 2001, which caused permanent differences that would normally increase the effective tax rate (specifically, nondeductible goodwill) to instead reduce it. For the second quarter of 2002, RERC's effective tax rate reflects the discontinuation of goodwill amortization in accordance with SFAS No. 142, offset by higher state tax expense than in the same period of 2001, when a state tax benefit was recorded.

RERC's effective tax rate for the first six months of 2002 was 38% compared to 49% for the same period in 2001. The decrease in the effective rate was primarily due to the discontinuance of goodwill amortization in accordance with SFAS No. 142 and other favorable adjustments.

Seasonality and Other Factors. RERC's results of operations are affected by seasonal fluctuations in the demand for and, to a lesser extent, the price of natural gas. RERC's results of operations are also affected by, among other things, the actions of various federal and state governmental authorities having jurisdiction over rates charged by RERC, competition in RERC's various business operations, debt service costs and income tax expense.

For a discussion of certain other factors that may affect RERC's future earnings, please read "Management's Narrative Analysis of Financial Condition and Results of Operations of Reliant Energy Resources Corp. and its Consolidated Subsidiaries -- Certain Factors Affecting Our Future Earnings --Factors Affecting the Results of RERC Operations" in the RERC Form 10-K/A, which information is incorporated herein by reference.

## NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141 "Business Combinations" (SFAS No. 141). SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles will be evaluated against these new criteria and may result in certain intangibles being transferred to goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. We adopted the provisions of the statement which apply to goodwill and intangible assets acquired prior to June 30, 2001 on January 1, 2002. The adoption of SFAS No. 141 did not have a material impact on our historical results of operations or financial position.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144). SFAS No. 144 provides new guidance on the recognition of impairment losses on long-lived assets to be held and used or to be disposed of and also broadens the definition of what constitutes a discontinued operation and how the results of a discontinued operation are to be measured and presented. SFAS No. 144 supercedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," while retaining many of the requirements of these two statements. Under SFAS No. 144, assets held for sale that are a component of an entity will be included in discontinued operations if the operations and cash flows will be or have been eliminated from the ongoing operations of the entity and the entity will not have any significant continuing involvement in the operations prospectively. SFAS No. 144 did not materially change the methods we use to measure impairment losses on long-lived assets, but may result in additional future dispositions being reported as discontinued operations than was previously permitted. We adopted SFAS No. 144 on January 1, 2002.

See Note 3 for a discussion of our adoption of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended (SFAS No. 133) on January 1, 2001. See Note 6 for a discussion of our adoption of SFAS No. 142 "Goodwill and Other Intangible Assets" (SFAS No. 142) on January 1, 2002.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections" (SFAS No. 145). SFAS No. 145 eliminates the current requirement that gains and losses on debt extinguishment must be classified as extraordinary items in the income statement. Instead, such gains and losses will be classified as extraordinary items only if they are deemed to be unusual and infrequent. SFAS No. 145 also requires that capital leases that are modified so that the resulting lease agreement is classified as an operating lease be accounted for as a sale-leaseback transaction. The changes related to debt extinguishment will be effective for fiscal years beginning after May 15, 2002, and the changes related to lease accounting will be effective for transactions occurring after May 15, 2002. We will apply this guidance prospectively.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS No. 146). SFAS No. 146 nullifies EITF No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" (EITF No. 94-3). The principal difference between SFAS No. 146 and EITF No. 94-3 relates to the requirements for recognition of a liability for cost associated with an exit or disposal activity. SFAS No. 146 requires that a liability be recognized for a cost associated with an exit or disposal activity when it is incurred. A liability is incurred when a transaction or event occurs that leaves an entity little or no discretion to avoid the future transfer or use of assets to settle the liability. Under EITF No. 94-3, a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. In addition, SFAS No. 146 also requires that a liability for a cost associated with an exit or disposal activity be recognized at its fair value when it is incurred. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002 with early application encouraged. We will apply the provisions of SFAS No. 146 to all exit or disposal activities initiated after December 31, 2002.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS.

For a description of legal proceedings affecting RERC, please review Note 11 to RERC's Interim Financial Statements, Item 3 of the RERC Corp. Form 10-K/A and Note 10 to the RERC Corp. 10-K/A Notes, which are incorporated herein by reference.

### ITEM 5. OTHER INFORMATION.

Forward-Looking Statements. From time to time, RERC Corp. makes statements concerning its expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are not historical facts. These statements are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those expressed or implied by these statements. You can generally identify the forward-looking statements by the words "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "plan," "potential," "predict," "should," "will," "forecast," "goal," "objective," "projection," or other similar words.

RERC Corp. has based its forward-looking statements on its management's beliefs and assumptions based on information available to its management at the time the statements are made. RERC Corp. cautions you that assumptions, beliefs, expectations, intentions and projections about future events may and often do vary materially from actual results. Therefore, RERC Corp. cannot assure you that actual results will not differ materially from those expressed or implied by its forward-looking statements.

The following are some of the factors that could cause actual results to differ materially from those expressed or implied in forward-looking statements:

- state, federal and international legislative and regulatory developments and changes in, or application of environmental, siting and other laws and regulations to which RERC Corp. is subject;
- timing of the implementation of our parent company's business separation plan;
- the effects of competition, including the extent and timing of the entry of additional competitors in our markets;
- industrial, commercial and residential growth in our service territories;
- our pursuit of potential business strategies, including acquisitions or dispositions of assets;
- state, federal and other rate regulations in the United States;
- the timing and extent of changes in commodity prices, particularly natural gas;
- weather variations and other natural phenomena;
- political, legal and economic conditions and developments in the United States;
- financial market conditions and the results of our financing efforts;
- any direct or indirect effect on our business resulting from the September 11, 2001 terrorist attacks or any similar incidents or responses to such incidents; and
- other factors we discuss in the RERC Corp. Form 10-K/A, including those outlined in "Management's Narrative Analysis of Results of Operations of Reliant Energy Resources Corp. and its Consolidated Subsidiaries -- Certain Factors Affecting Our Future Earnings."

You should not place undue reliance on forward-looking statements. Each forward-looking statement speaks only as of the date of the particular statement, and RERC Corp. undertakes no obligation to publicly update or revise any forward-looking statements.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits.

Exhibit 99 Items incorporated by reference from the RERC Corp. Form 10-K/A: Item 3 "Legal Proceedings," Item 7 "Management's Narrative Analysis of the Results of Operations of Reliant Energy Resources Corp. and its Consolidated Subsidiaries -- Certain Factors Affecting Our Future Earnings -- Factors Affecting the Results of RERC Operations" and Notes 3(f) (Regulatory Assets), 5 (Derivative Instruments), 7 (Trust Preferred Securities), 10 (Commitments and Contingencies) and 13 (Reportable Segments) of the RERC Corp. 10-K/A Notes.

(b) Reports on Form 8-K.

None.

## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

RELIANT ENERGY RESOURCES CORP.
(Registrant)

By: /s/ Mary P. Ricciardello
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Mary P. Ricciardello
Senior Vice President and Chief
Accounting Officer

Date: August 14, 2002

EXHIBIT 99

ITEM 3. LEGAL PROCEEDINGS.

For a description of certain legal and regulatory proceedings affecting us, see Notes 10(c) and 10(d) to our consolidated financial statements, which notes are incorporated herein by reference.

ITEM 7. MANAGEMENT'S NARRATIVE ANALYSIS OF THE RESULTS OF OPERATIONS OF RELIANT ENERGY RESOURCES CORP. AND ITS CONSOLIDATED SUBSIDIARIES.

CERTAIN FACTORS AFFECTING OUR FUTURE EARNINGS

Our past earnings are not necessarily indicative of our future earnings and results of operations. The magnitude of our future earnings and results of our operations will depend on numerous factors including:

- state, federal and international legislative and regulatory developments and changes in or application of environmental and other laws and regulations to which we are subject and changes in or application of laws or regulations applicable to other aspects of our business;

- the timing of the implementation of our parent company's Business Separation Plan;

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

- liquidity concerns in our markets;

- industrial, commercial and residential growth in our service territories;

- our pursuit of potential business strategies, including acquisitions or dispositions;

- state, federal and other rate regulations in the United States;

- the timing and extent of changes in interest rates and commodity prices, particularly natural gas;

- weather variations and other natural phenomena;

- our ability to cost-effectively finance and refinance;

- financial market conditions, our access to capital and the results of our financing efforts;

- the credit worthiness or bankruptcy or other financial distress of our trading, marketing and risk management services counterparties;

- actions by rating agencies with respect to us or our competitors;

- acts of terrorism or war;

- the availability and price of insurance; and

- political, legal, regulatory and economic conditions and developments in the United States.

In order to adapt to the increasingly competitive environment in our industry, we continue to evaluate a wide array of potential business strategies, including business combinations or acquisitions involving other utility or non-utility businesses or properties and dispositions of currently owned businesses.

FACTORS AFFECTING THE RESULTS OF RERC OPERATIONS

Natural Gas Distribution. Our Natural Gas Distribution business segment competes primarily with alternate energy sources such as electricity and other fuel sources. In some areas, intrastate pipelines, other gas distributors and marketers also compete directly with our Natural Gas Distribution business segment for gas sales to end-users. In addition, as a result of federal regulatory changes affecting interstate pipelines, natural gas marketers operating on these pipelines may be able to bypass our Natural Gas Distribution business segment's facilities and market, sell and/or transport natural gas directly to commercial and industrial customers.

Generally, the regulations of the states in which our Natural Gas Distribution business segment operates allow us to pass through changes in the costs of natural gas to our customers through purchased gas adjustment provisions in rates. There is, however, an inherent timing difference between our purchases of natural gas and the ultimate recovery of these costs. Consequently, we may incur additional "carrying" costs as a result of this timing difference and the resulting, temporary under-recovery of our purchased gas costs. To a large extent, these additional carrying costs are not recovered from our customers.

On November 21, 2001, Arkla filed a rate case (Docket 01-243-U) with the Arkansas Public Service Commission seeking an increase in rates for its Arkansas customers of approximately $47 million on an annual basis. Arkla's last rate increase was authorized in 1995. In the rate filing, Arkla maintains that its rate base has grown by $183 million, and its operating expenses have increased from $93 million to $106 million on an annual basis and, therefore, Arkla's current rates for service to Arkansas customers do not provide a reasonable opportunity for Arkla to cover its operating costs and earn a fair return on its investment. A decision in the case is expected in the fall of 2002.

Pipelines and Gathering. Our Pipelines and Gathering business segment competes with other interstate and intrastate pipelines in the transportation and storage of natural gas. The principal elements of competition among pipelines are rates, terms of service, and flexibility and reliability of service. Our Pipelines and Gathering business segment competes indirectly with other forms of energy available to its customers, including electricity, coal and fuel oils. The primary competitive factor is price. Changes in the availability of energy and pipeline capacity, the level of business activity, conservation and governmental regulations, the capability to convert to alternative fuels, and other factors, including weather, affect the demand for natural gas in areas we serve and the level of competition for transportation and storage services. Since FERC Order No. 636, REGT's and MRT's commodity sales activity has been minimal. Commodity transactions are usually related to system management activity which we have been able to manage with little exposure. We have not been nor do we anticipate being negatively impacted by higher price levels and the tightening of supply experienced in the fourth quarter of 2000 and the first quarter of 2001. In addition, competition for our gathering operations is impacted by commodity pricing levels in its markets because these prices influence the level of drilling activity in those markets.

Natural Gas Pipeline Company of America has proposed, and is soliciting customers for a 30" pipeline paralleling MRT's East Line in Illinois to a point 17 miles east of St. Louis Metro, with a proposed in-service date of June 2002. This service would represent an alternative to that provided by MRT. MRT has renewed or is engaged in negotiations to renew service agreements under multi-year terms, including service and potential expansion needs along MRT's existing East Line in Illinois. Our Pipelines and Gathering business segment derives approximately 14% of its revenues from Laclede Gas Company, which has an annual evergreen term provision. In February 2002, MRT negotiated an agreement to extend its existing service relationship with Laclede for a five year period subject to acceptance by the FERC. However, the Pipeline and Gathering business segment's financial results could be materially adversely affected after this five year period if Laclede decides to engage another pipeline for the transportation services currently provided by the Pipeline and Gathering business segment.

RELIANT ENERGY RESOURCES CORP. AND SUBSIDIARIES
(A WHOLLY OWNED SUBSIDIARY OF RELIANT ENERGY, INCORPORATED)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(f) Regulatory Assets.

RERC applies the accounting policies established in SFAS No. 71 "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71) to the accounts of the utility operations of Natural Gas Distribution and MRT. As of December 31, 2000 and 2001, RERC had recorded $5 million and $3 million, respectively, of net regulatory assets.

If, as a result of changes in regulation or competition, RERC's ability to recover these assets and liabilities would not be assured, then pursuant to SFAS No. 101, "Regulated Enterprises Accounting for the Discontinuation of Application of SFAS No. 71" (SFAS No. 101) and SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" (SFAS No. 121), RERC would be required to write off or write down these regulatory assets and liabilities. In addition, RERC would be required to determine any impairment to the carrying costs of plant and inventory assets.

(5) DERIVATIVE INSTRUMENTS

Effective January 1, 2001, RERC adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" as amended (SFAS No. 133), which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. This statement requires that derivatives be recognized at fair value in the balance sheet and that changes in fair value be recognized either currently in earnings or deferred as a component of other comprehensive income, depending on the intended use of the derivative instrument as hedging (a) the exposure to changes in the fair value of an asset or liability (Fair Value Hedge) or (b) the exposure to variability in expected future cash flows (Cash Flow Hedge) or (c) the foreign currency exposure of a net investment in a foreign operation. For a derivative not designated as a hedging instrument, the gain or loss is recognized in earnings in the period it occurs.

Adoption of SFAS No. 133 on January 1, 2001 resulted in a cumulative after-tax increase in accumulated other comprehensive income of $38 million. The adoption also increased current assets, long-term assets, current liabilities and long-term liabilities by approximately $88 million, $5 million, $53 million and $2 million, respectively, in RERC's Consolidated Balance Sheet. During the year ended December 31, 2001, $34 million of the initial after-tax transition adjustment recognized in other comprehensive income was recognized in net income.

During the third quarter of 2001, the FASB cleared an issue related to application of the normal purchases and normal sales exception to contracts that combine forward and purchased option contracts. The effective date of this guidance is April 1, 2002, and RERC is currently assessing the impact of this cleared issue and does not believe it will have a material impact on RERC's consolidated financial statements.

RERC is exposed to various market risks. These risks are inherent in RERC's consolidated financial statements and arise from transactions entered into in the normal course of business. RERC utilizes derivative financial instruments such as physical forward contracts, swaps and options (Energy Derivatives) to mitigate the impact of changes and cash flows of its natural gas on its operating results and cash flows.

(a) Non-Trading Activities.

Cash Flow Hedges. To reduce the risk from market fluctuations in revenues and the resulting cash flows derived from the sale of natural gas, RERC may enter into Energy Derivatives in order to hedge certain expected purchases and sales of natural gas (Non-trading Energy Derivatives). In 2001 these transactions were entered into with Reliant Energy Services, an affiliated company (See Note 2). The Non-trading Energy Derivative portfolios are managed to complement the physical transaction portfolio, reducing overall risks within authorized limits.

RERC applies hedge accounting for its Non-trading Energy Derivatives utilized in non-trading activities only if there is a high correlation between price movements in the derivative and the item designated as being hedged. This correlation, a measure of hedge effectiveness, is measured both at the inception of the hedge and on an ongoing basis, with an acceptable level of correlation of at least 80% to 120% for hedge designation. If and when correlation ceases to exist at an acceptable level, hedge accounting ceases and mark-to-market accounting is applied. During 2001, the amount of hedge ineffectiveness recognized in earnings from derivatives that are designated and qualify as Cash Flow Hedges was immaterial. No component of the derivative instruments' loss was excluded from the assessment of effectiveness. If it becomes probable that an anticipated transaction will not occur, RERC realizes in net income the deferred gains and losses recognized in accumulated other comprehensive loss. During the year ended December 31, 2001, there was a $3.6 million deferred loss recognized in earnings as a result of the discontinuance of cash flow hedges because it was no longer probable that the forecasted transaction would occur due to credit problems of a customer. Once the anticipated transaction occurs, the accumulated deferred gain or loss recognized in accumulated other comprehensive loss is reclassified and included in RERC's Statements of Consolidated Income under the caption "Natural Gas and Purchased Power." Cash flows resulting from these transactions in Non-trading Energy Derivatives are included in the Statements of Consolidated Cash Flows in the same category as the item being hedged. As of December 31, 2001, RERC's current non-trading derivative assets and liabilities and corresponding amounts in accumulated other comprehensive gain or loss were expected to be reclassified into net income during the next twelve months.

The maximum length of time RERC is hedging its exposure to the variability in future cash flows for forecasted transactions on existing financial instruments is primarily two years with a limited amount of exposure up to three years. RERC's policy is not to exceed five years in hedging its exposure.

(b) Energy Trading, Marketing and Price Risk Management Activities.

During 2000 and in prior years, RERC offered energy, price risk management services through a subsidiary, Reliant Energy Services. In December 2000, Reliant Energy Services was transferred to an affiliated company. Reliant Energy Services offered energy price risk management services primarily related to natural gas, electric power and other energy related commodities. Reliant Energy Services provided these services by utilizing a variety of derivative financial instruments, including (a) fixed and variable-priced physical forward contracts, (b) fixed and variable-priced swap agreements, (c) options traded in the over-the-counter financial markets and (d) exchange-traded energy futures and option contracts (Trading Derivatives). Fixed-price swap agreements require payments to, or receipts of payments from, counterparties based on the differential between a fixed and variable price for the commodity. Variable-price swap agreements require payments to, or receipts of payments from, counterparties based on the differential between industry pricing publications or exchange quotations.

RERC applied mark-to-market accounting for all of its energy trading, marketing and price risk management operations. Accordingly, these Trading Derivatives were recorded at fair value with realized and unrealized gains (losses) recorded as a component of revenues prior to the Merger. There were no recognized, unrealized balances (energy trading, marketing and price risk management assets/liabilities) as of December 31, 2000 and 2001.

(c) Credit Risks.

In addition to the risk associated with price movements, credit risk is also inherent in RERC's non-trading derivative activities. Credit risk relates to the risk of loss resulting from non-performance of contractual obligations by a counterparty. RERC enters into financial transactions to hedge purchases and sales with Reliant Energy Services as the counterparty since December 2000. Reliant Energy Services, an affiliated company, enters into financial transactions with unaffiliated parties to complete the hedge transaction and assumes the risk of loss from unaffiliated parties. As of December 31, 2001, the counterparty for all of RERC's non-trading derivative assets and liabilities was Reliant Energy Services.

(d) Trading and Non-trading - General Policy.

Reliant Energy has established a Risk Oversight Committee comprised of corporate and business segment officers that oversees all commodity price and credit risk activities, including Reliant Energy's trading, marketing, risk management services and hedging activities. The committee's duties are to establish Reliant Energy's commodity risk policies, allocate risk capital within limits established by Reliant Energy's board of directors, approve trading of new products and commodities, monitor risk positions and ensure compliance with Reliant Energy's risk management policies and procedures and trading limits established by Reliant Energy's board of directors.

Reliant Energy's policies prohibit the use of leveraged financial instruments. A leveraged financial instrument, for this purpose, is a transaction involving a derivative whose financial impact will be based on an amount other than the notional amount or volume of the instrument.

(7) TRUST PREFERRED SECURITIES

In June 1996, a Delaware statutory business trust created by RERC Corp. (RERC Trust) issued $173 million aggregate amount of convertible preferred securities to the public. RERC Corp. accounts for RERC Trust as a wholly owned consolidated subsidiary. RERC Trust used the proceeds of the offering to purchase convertible junior subordinated debentures issued by RERC Corp. having an interest rate and maturity date that correspond to the distribution rate and mandatory redemption date of the convertible preferred securities. The convertible junior subordinated debentures represent RERC Trust's sole assets and its entire operations. RERC Corp. considers its obligation under the Amended and Restated Declaration of Trust, Indenture and Guaranty Agreement relating to the convertible preferred securities, taken together, to constitute a full and unconditional guarantee by RERC Corp. of RERC Trust's obligations with respect to the convertible preferred securities.

The convertible preferred securities are mandatorily redeemable upon the repayment of the convertible junior subordinated debentures at their stated maturity or earlier redemption. Each convertible preferred security is convertible at the option of the holder into $33.62 of cash and 1.55 shares of Reliant Energy common stock. At Restructuring, each convertible preferred security is convertible into 1.55 shares of CenterPoint Energy common stock and $33.62 in cash. At Distribution, each convertible preferred security is convertible into an increased number of shares of CenterPoint Energy common stock based on a formula in the indenture governing the junior subordinated debentures and $33.62 in cash. During 2000 and 2001, convertible preferred securities of $0.3 million and $0.04 million, respectively, were converted. As of December 31, 2000 and 2001, $0.4 million liquidation amount of convertible preferred securities were outstanding. The securities, and their underlying convertible junior subordinated debentures, bear interest at 6.25% and mature in June 2026. Subject to some limitations, RERC Corp. has the option of deferring payments of interest on the convertible junior subordinated debentures. During any deferral or event of default, RERC Corp. may not pay dividends on its common stock to Reliant Energy. As of December 31, 2001, no interest payments on the convertible junior subordinated debentures had been deferred.

(10) COMMITMENTS AND CONTINGENCIES

(a) Capital and Environmental Commitments.

RERC has various commitments for capital and environmental expenditures. RERC anticipates investing up to $6 million in capital and other special project expenditures between 2002 and 2006 for environmental compliance.

(b) Lease Commitments.

The following table sets forth information concerning RERC's obligations under non-cancelable long-term operating leases principally consisting of rental agreements for building space, data processing equipment and vehicles, including major work equipment (in millions):

| | |
|---|---|
| 2002 | $ 14 |
| 2003 | 12 |
| 2004 | 7 |
| 2005 | 6 |
| 2006 | 5 |
| 2007 and beyond | 66 |
| Total | $110 |

Total rental expense for all operating leases was $33 million, $33 million and $32 million in 1999, 2000 and 2001, respectively.

(b) Transportation Agreement.

Prior to the merger of a subsidiary of Reliant Energy and RERC Corp., a predecessor of Reliant Energy Services entered into a transportation agreement (ANR Agreement) with ANR Pipeline Company (ANR) that contemplated a transfer to ANR of an interest in some of RERC's pipelines and related assets. The interest represented capacity of 250 million cubic feet (Mmcf)/day. Under the ANR Agreement, an ANR affiliate advanced $125 million to RERC. Subsequently, the parties restructured the ANR Agreement and RERC refunded in 1993 and 1995, $34 million and $50 million, respectively, to ANR. RERC has agreed to reimburse Reliant Energy Services for any transportation payments made under the ANR agreement and for the refund of the $41 million. In RERC's Consolidated Balance Sheet, RERC has recorded a long-term notes payable to Reliant Energy Services of $31 million and a deferred obligation to ANR of $10 million as of December 31, 2001.

(c) Environmental Matters.

Hydrocarbon Contamination. On August 24, 2001, 37 plaintiffs filed suit against Reliant Energy Gas Transmission Company, Inc., Reliant Energy Pipeline Services, Inc., RERC, Reliant Energy Services, and other Reliant Energy entities and third parties (Docket No. 460, 916-Div. "B"), in the 1st Judicial District Court, Caddo Parish, Louisiana. The petition has now been supplemented five times. As of March 11, 2002, there were 628 plaintiffs, a majority of whom are Louisiana residents who live near the Wilcox Aquifer. In addition to the Reliant Energy entities, the plaintiffs have sued the State of Louisiana through its Department of Environmental Quality, several individuals, some of whom are present employees of the State of Louisiana, the Bayou South Gas Gathering

Company, L.L.C., Martin Timber Company, Inc., and several trusts.

The suit alleges that, at some unspecified date prior to 1985, the defendants allowed or caused hydrocarbon or chemical contamination of the Wilcox Aquifer which lies beneath property owned or leased by the defendants and which is the sole or primary drinking water aquifer in the area. The primary source of the contamination is alleged by the plaintiffs to be a gas processing facility in Haughton, Bossier Parish, Louisiana known as the "Sligo Facility." This facility was purportedly used for gathering natural gas from surrounding wells, separating gasoline and hydrocarbons from the natural gas for marketing, and transmission of natural gas for distribution. This site was originally leased and operated by predecessors of Reliant Energy Gas Transmission Company in the late 1940s and was operated until Arkansas Louisiana Gas Company ceased operations of the plant in the late 1970s.

Beginning about 1985, the predecessors of certain Reliant Energy defendants engaged in a voluntary remediation of any subsurface contamination of the groundwater below the property they own or lease. This work has been done in conjunction with and under the direction of the Louisiana Department of Environmental Quality. The plaintiffs seek monetary damages for alleged damage to the aquifer underlying their property, unspecified alleged personal injuries, alleged fear of cancer, alleged property damage or diminution of value of their property, and in addition seek damages for trespass, punitive, and exemplary damages. The quantity of monetary damages sought is unspecified. As of December 31, 2001, RERC is unable to estimate the monetary damages, if any, that the plaintiffs may be awarded in this matter.

Manufactured Gas Plant Sites. RERC and its predecessors operated a manufactured gas plant (MGP) until 1960 adjacent to the Mississippi River in Minnesota formerly known as Minneapolis Gas Works (MGW). RERC has substantially completed remediation of the main site other than ongoing water monitoring and treatment. The manufactured gas was stored in separate holders. RERC is negotiating cleanup of one such holder. There are six other former MGP sites in the Minnesota service territory. Remediation has been completed on one site. Of the remaining five sites, RERC believes that two were neither owned nor operated by RERC. RERC believes it has no liability with respect to the sites it neither owned nor operated.

At December 31, 2000 and 2001, RERC had accrued $18 million and $23 million, respectively, for remediation of the Minnesota sites. At December 31, 2001, the estimated range of possible remediation costs was $11 million to $49 million. The cost estimates of the MGW site are based on studies of that site. The remediation costs for the other sites are based on industry average costs for remediation of sites of similar size. The actual remediation costs will be dependent upon the number of sites remediated, the participation of other potentially responsible parties (PRP), if any, and the remediation methods used.

Issues relating to the identification and remediation of MGPs are common in the natural gas distribution industry. RERC has received notices from the United States Environmental Protection Agency and others regarding its status as a PRP for other sites. Based on current information, RERC has not been able to quantify a range of environmental expenditures for potential remediation expenditures with respect to other MGP sites.

Other Minnesota Matters. At December 31, 2000 and 2001, RERC had recorded accruals of $4 million and $5 million, respectively for other environmental matters in Minnesota for which remediation may be required. At December 31, 2001, the estimated range of possible remediation costs was $4 million to $8 million.

Mercury Contamination. RERC's pipeline and distribution operations have in the past employed elemental mercury in measuring and regulating equipment. It is possible that small amounts of mercury may have been spilled in the course of normal maintenance and replacement operations and that these spills may have contaminated the immediate area with elemental mercury. This type of contamination has been found by RERC at some sites in the past, and RERC has conducted remediation at sites found to be contaminated. Although RERC is not aware of additional specific sites, it is possible that other contaminated sites may exist and that remediation costs may be incurred for these sites. Although the total amount of these costs cannot be known at this time, based on experience by RERC and that of others in the natural gas industry to date and on the current regulations regarding remediation of these sites, RERC believes that the costs of any remediation of these sites will not be material to RERC's financial position, results of operations or cash flows.

Potentially Responsible Party Notifications. From time to time RERC has received notices from regulatory authorities or others regarding its status as a PRP in connection with sites found to require remediation due to the presence of environmental contaminants. Considering the information currently known about such sites and the involvement of RERC in activities at these sites, RERC does not believe that these matters will have a material adverse effect on RERC's financial position, results of operations or cash flows.

(d) Other Legal Matters.

California Wholesale Market. Reliant Energy, Reliant Energy Services (a wholly owned subsidiary of Reliant Resources), Reliant Energy Power Generation, Inc. (a wholly owned subsidiary of Reliant Resources) and several other subsidiaries of Reliant Resources, as well as three officers of some of these companies, have been named as defendants in class action lawsuits and other lawsuits filed against a number of companies that own generation plants in California and other sellers of electricity in California markets. RERC had also been named as a defendant in one of these actions. Plaintiffs have voluntarily dismissed Reliant Energy from two of the three class actions in which it was named as a defendant. Plaintiffs have also voluntarily dismissed RERC from the one action in which it was named as a defendant.

Natural Gas Measurement Lawsuits. In 1997, a suit was filed under the Federal False Claim Act against RERC, REGT and REFS alleging mismeasurement of natural gas produced from federal and Indian lands. The suit seeks undisclosed damages, along with statutory penalties, interest, costs, and fees. The complaint is part of a larger series of complaints filed against 77 natural gas pipelines and their subsidiaries and affiliates. An earlier single action making substantially similar allegations against the pipelines was dismissed by the U.S. District Court for the District of Columbia on grounds of improper joinder and lack of jurisdiction. As a result, the various individual complaints were filed in numerous courts throughout the country. This case was consolidated, together with the other similar False Claim Act cases filed and transferred to the District of Wyoming. Motions to dismiss were denied. The defendants intend to vigorously contest this case.

In addition, RERC, REGT, REFS and MRT have been named as defendants in a class action filed in May 1999 against approximately 245 pipeline companies and their affiliates. The plaintiffs in the case purport to represent a class of natural gas producers and fee royalty owners who allege that they have been subject to systematic gas mismeasurement by the defendants, including certain Reliant Energy entities, for more than 25 years. The plaintiffs seek compensatory damages, along with statutory penalties, treble damages, interest, costs and fees. The action is currently pending in state court in Stevens County, Kansas. Plaintiffs initially sued Reliant Energy Services, but that company was dismissed without prejudice on June 8, 2001. Other Reliant Energy entities that were misnamed or duplicative have also been dismissed. MRT and REFS have filed motions to dismiss for lack of personal jurisdiction and are currently responding to discovery on personal jurisdiction. All four Reliant Energy defendants have joined in a motion to dismiss.

The defendants plan to raise significant affirmative defenses based on the terms of the applicable contracts, as well as on the broad waivers and releases in take or pay settlements that were granted by the producer-sellers of natural gas who are putative class members.

Other. RERC is a party to other litigation (other than that specifically noted) which arises in the normal course of business. Management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. Management believes that the effects, if any, from the disposition of these matters will not have a material adverse effect on RERC's financial position, results of operations or cash flows.

(13) REPORTABLE SEGMENTS

Because RERC Corp. is a wholly owned subsidiary of Reliant Energy, RERC's determination of reportable segments considers the strategic operating units under which Reliant Energy manages sales, allocates resources and assesses performance of various products and services to wholesale or retail customers in differing regulatory environments.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies except that some executive benefit costs have not been allocated to segments. RERC evaluates performance based on operating income, excluding some corporate costs not allocated to the segments. RERC accounts for intersegment sales as if the sales were to third parties, that is, at current market prices.

RERC's financial reporting segments include the following: Natural Gas Distribution, Pipelines and Gathering, Wholesale Energy and Other Operations. Natural Gas Distribution consists of intrastate natural gas sales to, and natural gas transportation for, residential, commercial and industrial customers, and some non-rate regulated retail gas marketing operations. Pipelines and Gathering includes the interstate natural gas pipeline operations and natural gas gathering and pipeline services. Reliant Energy Services was previously reported within the Wholesale Energy segment. Other Operations includes unallocated general corporate expenses and non-operating investments. During 2000, Reliant Energy transferred RERC's non-rate regulated retail gas marketing from Other Operations to Natural Gas Distribution and RERC's natural gas gathering business from Wholesale Energy to Pipelines and Gathering. On December 31, 2000, RERC Corp. transferred all of the outstanding stock of RESI, Arkla Finance and RE Europe Trading, all wholly owned subsidiaries of RERC Corp., to Reliant Resources. Also, on December 31, 2000, a wholly owned subsidiary of Reliant Resources merged with and into Reliant Energy Services, a wholly owned subsidiary of RERC Corp., with Reliant Energy Services as the surviving corporation. As a result of the Merger, Reliant Energy Services became a wholly owned subsidiary of Reliant Resources. Reportable segments from previous years have been restated to conform to the 2001 presentation. All of RERC's long-lived assets are in the United States.

Financial data for business segments and products and services are as follows:

SALES TO PIPELINES NON-
NATURAL GAS AND WHOLESALE
OTHER RECONCILING RERC
DISTRIBUTION GATHERING ENERGY
OPERATIONS ELIMINATIONS
AFFILIATES CONSOLIDATED -----
------- --------- --------- -
--------- ------------ ------
---- ------------ (IN
MILLIONS) AS OF AND FOR THE
YEAR ENDED DECEMBER 31, 1999:
Revenues from external
customers.... $ 2,735 $ 151 $

6,024 $ 8 $ -- $ 197 $ 9,115
Intersegment
revenues............... 46
180 264 -- (490) -- --
Depreciation and
amortization....... 137 53 6
3 -- -- 199 Operating income
(loss)............. 159 131
27 (16) -- -- 301 Total
assets........................
3,683 2,486 2,821 404 (1,841)
-- 7,553 Expenditures for
additions to long-lived
assets................. 206
79 3 -- -- -- 288 AS OF AND
FOR THE YEAR ENDED DECEMBER
31, 2000: Revenues from
external customers.... 4,445
177 16,150 1 -- 816 21,589
Intersegment
revenues............... 34
202 578 -- (814) -- --
Depreciation and
amortization....... 145 55 11
3 -- -- 214 Operating income
(loss)............. 121 137
86 (12) -- -- 332 Total
assets........................
4,518 2,358 -- 448 (748) --
6,576 Expenditures for
additions to long-lived
assets................. 195
61 27 8 -- -- 291 AS OF AND
FOR THE YEAR ENDED DECEMBER
31, 2001: Revenues from
external customers.... 4,638
225 -- -- -- 181 5,044
Intersegment
revenues............... 5 108
-- -- (113) -- --
Depreciation and
amortization....... 147 58 --
2 -- -- 207 Operating income
(loss)............. 130 137 -
- (1) -- -- 266 Total
assets........................
3,732 2,361 -- 495 (599) --
5,989 Expenditures for
additions to long-lived
assets................. 209
54 -- -- -- -- 263

YEAR ENDED DECEMBER 31, -----------------------------
--- 1999 2000 2001 -------- -------- -------- (IN
MILLIONS) RECONCILIATION OF OPERATING INCOME TO NET
INCOME: Operating income
......................................... $ 301 $
332 $ 266 Interest expense
......................................... (119)
(143) (155) Other, net
............................................... 11 2
14 Income taxes
............................................. (89)
(93) (58) Loss from discontinued operations
......................... (4) (24) -- -------- ------
-- -------- Net income
........................................... $ 100 $
74 $ 67 ======== ======== ======== REVENUES BY
PRODUCTS AND SERVICES: Retail gas sales
......................................... $ 2,735 $
4,358 $ 4,645 Wholesale energy and energy related
sales ................. 6,221 16,961 -- Gas transport
........................................... 152 182
307 Energy products and services
.............................. 7 88 92 -------- -----
--- -------- Total
............................................... $
9,115 $ 21,589 $ 5,044 ======== ======== ========
REVENUES BY GEOGRAPHIC AREAS U.S.
.....................................................
$ 8,998 $ 20,539 $ 5,044 Canada
...................................................
117 1,050 -- -------- -------- -------- Total
............................................... $
9,115 $ 21,589 $ 5,044 ======== ======== ========