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RELIANT RESOURCES INC
Form S-3/A
December 10, 2003

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON DECEMBER 10, 2003

REGISTRATION NO. 333-107295

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

AMENDMENT NO. 1

TO

FORM S-3
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

RELIANT RESOURCES, INC.
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE
(State or Other Jurisdiction
of Incorporation or Organization)

76-0655566
(I.R.S. Employer
Identification Number)

1000 MAIN STREET
HOUSTON, TEXAS 77002
(713) 497-3000
(Address, Including Zip Code, and Telephone Number, Including Area Code,
of Registrant's Principal Executive Offices)

MICHAEL L. JINES
SENIOR VICE PRESIDENT, GENERAL COUNSEL
AND CORPORATE SECRETARY
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HOUSTON, TEXAS 77002
(713) 497-3000
(Name, Address, Including Zip Code, and Telephone Number,
Including Area Code, of Agent For Service)

COPIES TO:

MICHAEL P. ROGAN

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APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC: As soon as practicable after this Registration Statement becomes effective.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. []

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. [X]

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. []

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE SECURITIES AND EXCHANGE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. THE SELLING SECURITY HOLDERS MAY NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND IT IS NOT SOLICITING OFFERS TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

SUBJECT TO COMPLETION, DATED DECEMBER 10, 2003

(RELIANT RESOURCES LOGO)

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\$275,000,000

RELIANT RESOURCES, INC.

5.00% CONVERTIBLE SENIOR SUBORDINATED NOTES DUE 2010 AND SHARES OF
COMMON STOCK ISSUABLE UPON CONVERSION OF THE NOTES

On June 24, 2003, we issued and sold \$225,000,000 aggregate principal amount of our 5.00% Convertible Senior Subordinated Notes due 2010 to Deutsche Bank Securities Inc., Goldman, Sachs & Co., Banc of America Securities LLC, Barclays Capital Inc., ABN AMRO Rothschild LLC and Commerzbank Capital Markets Corp. (the initial purchasers) in a private placement. On July 2, 2003, we issued and sold, at the option of the initial purchasers, an additional \$50,000,000 aggregate principal amount of the notes to the initial purchasers to cover overallocments. This prospectus will be used by selling securityholders to resell the notes and register the common stock issuable upon conversion of the notes.

The notes will mature on August 15, 2010. You may convert the notes into shares of Reliant Resources' common stock at any time prior to their maturity or one business day prior to their redemption or repurchase by Reliant Resources. The conversion rate is 104.8108 shares of common stock per each \$1,000 principal amount of notes, subject to adjustment in certain circumstances. This is equivalent to a conversion price of approximately \$9.54 per share. On December 5, 2003, the last reported sale price for the common stock on The New York Stock Exchange was \$6.16 per share. The common stock is listed under the symbol "RRI".

Reliant Resources will pay interest on the notes on February 15 and August 15 of each year. The first interest payment was made on August 15, 2003. The notes are subordinated in right of payment to all of Reliant Resources' existing and future senior debt and effectively subordinated to all indebtedness and liabilities of Reliant Resources' subsidiaries. As of September 30, 2003, the aggregate amount of Reliant Resources' outstanding senior debt, as defined in this prospectus, was approximately \$4.4 billion and the aggregate amount of indebtedness and other liabilities of Reliant Resources' subsidiaries was approximately \$5.6 billion (excluding \$1.9 billion related to Reliant Resources' European energy operations and Desert Basin plant operations). The notes were issued only in denominations of \$1,000 and integral multiples of \$1,000.

On or after August 20, 2008, Reliant Resources has the option to redeem the notes, in whole or in part, at the prices described in this prospectus if the last reported sale price of Reliant Resources' common stock is at least 125% of the then effective conversion price for at least 20 trading days within a period of 30 consecutive trading days ending on the trading day before the date of the redemption notice. You have the option, subject to certain conditions, to require Reliant Resources to repurchase any notes held by you in the event of a change of control, as described in this prospectus, at a price equal to 100% of the principal amount of the notes plus accrued and unpaid interest to the date of repurchase.

The notes are evidenced by a global note deposited with a custodian for and registered in the name of a nominee of The Depository Trust Company. Except as described in this prospectus, beneficial interests in the global note will be shown on, and transfers thereon will be effected only through, records maintained by The Depository Trust Company and its direct and indirect participants.

We will not receive any of the proceeds from the sale of the notes or the

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shares of common stock by any of the selling securityholders. The notes and the shares of common stock may be offered in negotiated transactions or otherwise, at market prices prevailing at the time of sale or at negotiated prices. The timing and amount of any sale are within the sole discretion of the selling securityholders. In addition, the shares of common stock may be offered from time to time through ordinary brokerage transactions on the New York Stock Exchange. See "Plan of Distribution." The selling securityholders may be deemed to be "underwriters" as defined in the Securities Act of 1933, as amended. Any profits realized by the selling securityholders may be deemed to be underwriting commissions. If the selling securityholders use any broker-dealers, any commission paid to broker-dealers and, if broker-dealers purchase any notes or shares of common stock as principals, any profits received by such broker-dealers on the resale of the notes or shares of common stock may be deemed to be underwriting discounts or commissions under the Securities Act.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

SEE "RISK FACTORS" BEGINNING ON PAGE 14 TO READ ABOUT IMPORTANT FACTORS YOU SHOULD CONSIDER BEFORE BUYING THE NOTES.

Prospectus dated December, 2003.

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WHERE YOU CAN FIND MORE INFORMATION

Reliant Resources files annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission, or SEC. You may read and copy any document Reliant Resources files at the SEC's public reference room in Washington, D.C., 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-888-SEC-0330 for further information on the public reference room. Our SEC filings are also available to the public from the SEC's web site at www.sec.gov or from Reliant Resources' web site at www.reliantresources.com. However, the information on Reliant Resources' web site does not constitute a part of this prospectus.

In this document, Reliant Resources "incorporates by reference" the information it files with the SEC, which means that Reliant Resources can disclose important information to you by referring to that information. The information incorporated by reference is considered to be a part of this prospectus, and later information filed with the SEC will update and supersede this information. Reliant Resources incorporates by reference the documents listed below and any future filings made with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, or the Exchange Act, after the date of the initial registration statement and prior to the effectiveness of the registration statement and any filings thereafter and prior to the termination of this offering:

- Reliant Resources' Annual Report on Form 10-K/A filed on May 1, 2003 for the fiscal year ended December 31, 2002;
- Reliant Resources' Proxy Statement on Schedule 14A, filed on April 30, 2003;
- Reliant Resources' Quarterly Report on Form 10-Q filed on May 14, 2003 for the quarter ended March 31, 2003;

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- Reliant Resources' Quarterly Report on Form 10-Q filed on August 13, 2003 for the quarter ended June 30, 2003;
- Reliant Resources' Quarterly Report on Form 10-Q filed on November 12, 2003 for the quarter ended September 30, 2003;
- Reliant Resources' Current Report on Form 8-K filed on January 10, 2003;
- Reliant Resources' Current Report on Form 8-K filed on February 3, 2003;
- Reliant Resources' Current Report on Form 8-K filed on February 24, 2003;
- Reliant Resources' Current Report on Form 8-K filed on March 17, 2003;
- Reliant Resources' Current Report on Form 8-K filed on March 24, 2003;
- Reliant Resources' Current Report on Form 8-K filed on March 28, 2003;
- Reliant Resources' Current Report on Form 8-K filed on April 1, 2003 (to the extent filed by Reliant Resources under the Securities Exchange Act of 1934);

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- Reliant Resources' Current Report on Form 8-K filed on April 16, 2003 (other than Exhibit 99.2);
- Reliant Resources' Current Report on Form 8-K filed on May 12, 2003;
- Reliant Resources' Current Report on Form 8-K filed on June 5, 2003;
- Reliant Resources' Current Report on Form 8-K filed on June 18, 2003;
- Reliant Resources' Current Report on Form 8-K filed on June 24, 2003;
- Reliant Resources' Current Report on Form 8-K filed on June 30, 2003;
- Reliant Resources' Current Report on Form 8-K filed on July 11, 2003;

- Reliant Resources' Current Report on Form 8-K filed on July 23, 2003;

- Reliant Resources' Current Report on Form 8-K filed on August 12, 2003 (to the extent filed by Reliant Resources under the Securities Exchange Act of 1934);

- Reliant Resources' Current Report on Form 8-K filed on August 26, 2003;

- Reliant Resources' Current Report on Form 8-K filed on September 26, 2003;

- Reliant Resources' Current Report (items 5 and 7) on Form 8-K filed on November 14, 2003;

- Reliant Resources' Current Report on Form 8-K filed on November 26, 2003;

- Reliant Resources' Current Report on Form 8-K filed on December 9, 2003; and

- the description of Reliant Resources' common stock, par value \$.001 per share contained in Reliant Resources' Registration Statement on Form 8-A, filed with the SEC on April 27, 2001, as amended by Amendment No. 1 thereto on Form 8-A/A, filed with the SEC on May 1, 2001.

You may request a copy of these filings at no cost, by writing or telephoning Reliant Resources at: P.O. Box 148, Houston, Texas 77001-0148, Attention: Investor Relations, telephone (713) 497-7000.

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For our most recent annual consolidated financial statements and notes, see our Current Report on Form 8-K filed on November 14, 2003 and incorporated by reference herein. For our most recent annual "Management's Discussion and Analysis of Financial Condition and Results of Operations," see our Current Report on Form 8-K filed on November 14, 2003 and incorporated by reference herein. For our most recent interim consolidated financial statements and notes and interim "Management's Discussion and Analysis of Financial Condition and Results of Operations," see our Quarterly Report on Form 10-Q filed on November 12, 2003 and incorporated by reference herein.

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You should rely only upon the information provided in this document or incorporated in this document by reference. Reliant Resources has not authorized anyone to provide you with different information. You should not assume that the information in this document, including any information incorporated by reference, is accurate as of any date other than the date indicated on the front cover.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

When we make statements containing projections about our revenues, income, earnings and other financial items, our plans and objectives for the future, future economic performance, transactions for the sale of parts of our operations and financings related thereto, or when we make statements containing any other projections or estimates about our assumptions relating to these types of statements, we are making "forward-looking statements." These statements usually relate to future events and anticipated revenues, earnings, business strategies, competitive position or other aspects of our operations or operating results. In many cases you can identify forward-looking statements by terminology such as "anticipate," "estimate," "believe," "continue," "could," "intend," "may," "plan," "potential," "predict," "should," "will," "expect," "objective," "projection," "forecast," "goal," "guidance," "outlook" and other similar words. However, the absence of these words does not mean that the statements are not forward-looking. Although we believe that the expectations and the underlying assumptions reflected in our forward-looking statements are reasonable, there can be no assurance that these expectations will prove to be correct. Forward-looking statements are not guarantees of future performance or events. Such statements involve a number of risks and uncertainties, and actual results may differ materially from the results discussed in the forward-looking statements.

In addition to the matters described in this prospectus, the following are some of the factors that could cause actual results to differ materially from those expressed or implied in our forward-looking statements:

- Changes in laws and regulations, including deregulation, re-regulation and restructuring of the electric utility industry, 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

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applicable to other aspects of our business, such as hedging activities;

- The outcome of pending lawsuits, governmental proceedings and investigations;

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

- Liquidity concerns in our markets;

- Our pursuit of potential business strategies;

- The timing and extent of changes in commodity prices and interest rates;

- The availability of adequate supplies of fuel, water, and associated transportation necessary to operate our portfolio of generation assets;

- Weather variations and other natural phenomena, which can affect the demand for power from or our ability to produce power at our generating facilities;

- Financial market conditions and our access to capital, including availability of funds in the capital markets for merchant generation companies;

- The creditworthiness or bankruptcy or other financial distress of our counterparties;

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

- Acts of terrorism or war;

- The availability and price of insurance;

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- Political, legal, regulatory and economic conditions and developments;
- The successful operation of deregulating power markets; the reliability of the systems, procedures and other infrastructure necessary to operate our retail electric business, including the systems owned and operated by the independent system operator in ERCOT; and
- The resolution of the refusal by certain California market participants to pay our receivables balances and the resolution of the refund methodologies.

Each forward-looking statement speaks only as of the date of the particular statement and we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

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PROSPECTUS SUMMARY

In this prospectus, the words "Reliant Resources" and "RRI" refer to Reliant Resources, Inc. and the words, "we", "our", "ours", and "us" refer to Reliant Resources, Inc. and its subsidiaries. The following summary contains basic information about us, the notes and our common stock. It does not contain all of the information that may be important to you. For a complete understanding of us, the notes and our common stock, we encourage you to read this entire document and the documents we have referred you to herein. We provide a glossary of terms used in this prospectus beginning on page A-1.

COMPANY OVERVIEW

We provide electricity and energy services with a focus on the competitive retail and wholesale segments of the electric power industry in the United States. With respect to the retail segment of the industry, we provide customized electricity and related energy services to large commercial, industrial and institutional customers in Texas and, to a lesser extent, in the Pennsylvania -- New Jersey -- Maryland (PJM) Interconnection. We also provide standardized electricity and related services to residential and small commercial customers in Texas. Within the wholesale segment of the industry, we own and/or operate a substantial number of electric power generating units dispersed broadly across the United States. These units are not subject to traditional cost-based regulation; therefore, we can generally sell electricity at prices determined by the market, subject to regulatory limitations. We market electric energy, capacity and ancillary services and procure and, in some instances, resell natural gas, coal, fuel oil, natural gas transportation capacity and other energy-related commodities to optimize our physical assets and manage the risk of our asset portfolio. We sell energy commodities to and buy energy commodities from a variety of over-the-counter and exchange-based markets, as well as directly to or from energy producers, distributors and retailers, as appropriate.

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RETAIL ENERGY

Our retail energy segment provides electricity products and services to end-use customers, ranging from residential and small commercial customers to large commercial, industrial and institutional customers. Our retail energy segment acquires and manages the electric energy, capacity and ancillary services associated with supplying these retail customers. We began serving approximately 1.7 million electric customers in the Houston metropolitan area when the Texas market opened to full competition in January 2002. We also began serving customers in other areas of Texas, which were obtained through our marketing efforts. As of September 30, 2003, our total retail customer count in Texas, as measured by number of metered locations, had increased approximately five percent as compared to September 30, 2002 due to customers added in markets outside of the Houston area. We are taking steps to provide electricity and related products and services to large commercial, industrial and institutional customers in certain other states. In New Jersey, we are registered as an "electric power supplier," in Pennsylvania, we are registered as an "electric generation supplier" and in Maryland, we are licensed as an "electric supplier." We began to deliver electricity in New Jersey effective August 1, 2003.

WHOLESALE ENERGY

Our wholesale energy segment includes our non-Texas portfolio of electric power generation facilities and related purchased power, fuel delivery and storage asset positions. We own and/or operate a substantial number of electric power generating units dispersed broadly across the United States. These units are not subject to traditional cost-based regulation; therefore, we can generally sell electricity at prices determined by the market, subject to regulatory limitations. We market electric energy, capacity and ancillary services and procure and, in some instances, resell natural gas, coal, fuel oil, natural gas transportation capacity and other energy-related commodities to optimize our physical assets and manage the risk of our asset portfolio. We sell energy commodities to and buy energy commodities from a variety of over-the-counter and exchange-based markets, as well as directly to or from energy producers, distributors and retailers, as appropriate.

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We own, own an interest in, or lease 119 operating electric power generation facilities with an aggregate net generating capacity of 19,279 MW located in five regions of the United States -- the Mid-Atlantic, New York, the Mid-Continent, the Southeast and the West regions. This excludes 588 MW related to our Desert Basin plant, which was sold in October 2003, and 811 MW related to the retirement of certain units in the West and Mid-Atlantic regions. We have 1,063 MW of additional net generating capacity under construction. One gas-fired generating facility (541 MW) is due to reach commercial operation in the fourth quarter of 2003 and one waste-coal fired generating facility (522 MW) is due to reach commercial operation in the second half of 2004. The generating capacity of these facilities consists of approximately 25% of base-load, 44% of intermediate and 31% of peaking capacity. Our generating capacity is fueled 42% by natural gas, 21% by coal, 3% by oil and 30% has dual-fuel capability. The remaining 4% of our generating capacity is hydroelectric.

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The following table describes our electric power generation facilities and net generating capacity by region as of December 5, 2003:

REGION	NUMBER OF GENERATION FACILITIES (1)	TOTAL NET GENERATING CAPACITY (MW) (2)	DISPATCH TYPE (3)	FUEL
MID-ATLANTIC				
Operating (4) (5)	21	5,161	Base, Intermediate, Peak Base	Gas/Coal/ Coal
Under Construction (6) (7)	1	522		
Combined	22	5,683		
NEW YORK				
Operating (8)	77	2,952	Base, Intermediate, Peak	Gas/Oil/H
MID-CONTINENT				
Operating	9	4,484	Base, Intermediate, Peak	Gas/Oil/O
SOUTHEAST				
Operating (9) (10)	6	3,010	Base, Intermediate, Peak	Gas/Oil
WEST				
Operating (11) (12) (13) (14) ...	6	3,672	Base, Intermediate, Peak Base, Intermediate	Gas/Oil Gas
Under Construction (6)	1	541		
Combined	7	4,213		
TOTAL				
Operating	119	19,279		
Under Construction	2	1,063		
Combined	121	20,342		

(1) Unless otherwise indicated, we own a 100% interest in each facility listed.

(2) Average summer and winter net generating capacity.

(3) We use the designations "Base," "Intermediate," and "Peak" to indicate whether the facilities described are base-load, intermediate, or peaking facilities, respectively.

(4) We lease a 100%, 16.67% and 16.45% interest in three Pennsylvania facilities having 614 MW, 284 MW and 282 MW of net generating capacity, respectively, through facility lease agreements having terms of 26.25 years, 33.75 years and 33.75 years, respectively.

(5) In October 2003, we announced the retirement of two Mid-Atlantic generation units having 232 MW of net generating capacity, which are excluded from the table above.

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(6) We consider a project to be "under construction" once we have acquired the necessary permits to begin construction, broken ground on the project site and contracted to purchase machinery for the project, including the combustion turbines.

(7) In November 2003, we retired two generation units having 197 MW of net generating capacity at the Seward facility, which are excluded from the table above. This retirement was necessary to continue construction of the replacement capacity of 522 MW.

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(8) Excludes two hydro plants with a net generating capacity of 5 MW, which are not currently operational.

(9) We own a 50% interest in one of these facilities having a net generating capacity of 108 MW. An independent third party owns the other 50%.

(10) We are party to tolling agreements entitling us to 100% of the capacity of two Florida facilities having 630 MW and 474 MW of net generating capacity, respectively. These tolling agreements have terms of 10 years and 5 years, respectively, and are treated as operating leases for accounting purposes.

(11) In October 2003, we announced the retirement of two California generation units having 264 MW of total net generating capacity due to a lack of required environmental permits, which are excluded from the table above.

(12) At the end of December 2003, we will retire one California generation unit having 118 MW of net generating capacity, which are excluded from the table above, due to a lack of required environmental permits.

(13) We own a 50% interest in one Nevada facility having a total generating capacity of 470 MW. An independent third party owns the other 50%.

(14) In November 2003, we announced that the following units in California will be mothballed: two units at Etiwanda (640 MW); one unit at Mandalay (130 MW) and one unit at Ellwood (54 MW), which are included in the table above.

We seek to optimize our physical asset positions consisting of our power generation asset portfolio, pipeline transportation capacity positions, pipeline storage positions and fuel positions and provide risk management services for our asset positions. We perform these functions through procurement, marketing

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and hedging activities for power, fuels and other energy related commodities. With the downturn in the industry, the decline in market liquidity and our liquidity capital constraints, the principal function of our commercial activities is to optimize our assets. In March 2003, we decided to exit our proprietary trading activities and liquidate, to the extent practicable, our proprietary positions. Although we have exited our proprietary trading activities, we have legacy positions, which will be closed as economically feasible or in accordance with their terms. We will continue to engage in marketing and hedging activities related to our electric generating facilities, pipeline transportation capacity positions, pipeline storage positions and fuel positions of our wholesale energy segment and energy supply costs related to our retail energy segment.

DISCONTINUED OPERATIONS

In February 2003, we announced the sale of our European energy business to Nuon for approximately Euro 1.1 billion (on December 10, 2003, \$1.3 billion). The sale closed on December 10, 2003. In accordance with current accounting standards, the results of these operations are reported as discontinued operations.

On July 9, 2003, we entered into a definitive agreement to sell our 588 MW Desert Basin plant, located in Casa Grande, Arizona, to SRP of Phoenix for \$289 million. The sale closed on October 15, 2003. In accordance with current accounting standards, the results of these operations have been reflected as discontinued operations.

For additional information regarding discontinued operations, see notes 17 and 18 to our interim financial statements for the three and nine months ended September 30, 2003 incorporated by reference herein.

RECENT DEVELOPMENTS

On November 25, 2003, we entered into a settlement with the CFTC in connection with an investigation relating to trading and price reporting issues. The settlement addressed the reporting of natural gas trading information to energy industry publications that compile and report index prices and seven offsetting and pre-arranged electricity trades (involving standard, 25-megawatt electricity contracts) that were executed on an electronic trading platform in 2000. Pursuant to the terms of the settlement, one of our subsidiaries agreed to pay a civil monetary penalty of \$18 million.

On December 5, 2003, we announced that it is unlikely that we will exercise our option to purchase CenterPoint's holdings of common stock of Texas Genco. Pursuant to the terms of our credit and debt agreements, we have established an escrow account to repay indebtedness under our credit facility and for

general corporate purposes or for possible use in the acquisition of CenterPoint's holdings of common stock of Texas Genco.

After giving effect to the receipt of net cash proceeds expected to be received from the sale of our European energy segment, we expect that the total amount of cash on deposit in the escrow account will be approximately \$917 million.

If as expected, we do not exercise the Texas Genco option, our credit and debt agreements entitle us to maintain the funds in the restricted escrow account for the possible subsequent purchase of CenterPoint's holdings of common stock of Texas Genco (at a price not to exceed the option price) until the earlier of September 15, 2004 or the date that CenterPoint sells more than 20% of the outstanding common stock of Texas Genco to someone other than us.

Upon the occurrence of the earlier of those events, we would be required under the terms of our March 2003 credit facilities to apply the funds in the escrow account to collateralize the \$300 million senior priority loan commitment and to prepay term indebtedness under our March 2003 credit facilities. Once the senior priority commitment has terminated, we would be permitted to use 50% of the funds from our offering of convertible debt securities for general corporate purposes.

For additional information regarding the Texas Genco option, see our Current Report on Form 8-K filed December 9, 2003 incorporated by reference herein.

OBJECTIVES AND STRATEGY

We are committed to building a balanced wholesale and retail energy business. Achievement of this goal will be facilitated by focusing on the following strategic priorities:

OPTIMIZE OUR BUSINESS

Our retail energy business has a strong competitive position in Texas and has provided us with a stable source of earnings. Following deregulation, as anticipated, we have seen a loss of residential and small business market share in the Houston area service territory. We are pursuing customers in other markets outside of the Houston area service territory to mitigate the loss of this market share. As a result of such marketing efforts, we have made out-of-territory market share gains which have helped to offset losses within the Houston area service territory. Further, our business which provides electricity and energy services to customers with an aggregate peak demand of greater than approximately one MW has grown its market share substantially since deregulation and is poised to continue to grow in Texas. In addition, we have recently opened an office in New Jersey and are focused on building a strong position in the surrounding region.

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Our wholesale energy business consists of a portfolio of diverse generation assets which enable us to market electric energy, capacity and ancillary services. In addition, we procure and, in some instances, resell natural gas, coal, fuel oil, natural gas transportation capacity and other energy-related commodities and maintain a commercial infrastructure to optimize our physical assets and contractual positions through marketing and hedging activities. We focus on contracting our capacity and procuring the necessary fuel to generate that power, to lock in energy margins. While current market conditions are generally weak, we expect the profitability of our wholesale energy business to improve markedly when markets return to more balanced supply and demand fundamentals and market rules and regulations improve.

IMPROVE OUR CAPITAL STRUCTURE

Our March 2003 refinancing provided us liquidity and removed near-term debt maturities which enhances our ability to access the capital markets. Our business is an inherently cyclical one; consequently, we believe that we need a more balanced capital structure, and we intend to replace the majority of our bank debt with long-term fixed income debt and equity. Our first step in the process was our issuances of \$275 million of notes (\$225 million in June 2003 and \$50 million in July 2003) and \$1.1 billion of senior

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secured notes in July 2003. The net proceeds of the notes may be used to repay indebtedness under our credit facilities and for general corporate purposes or for the possible acquisition of CenterPoint's holdings of the common stock of Texas Genco and the net proceeds of the senior secured notes were used to pay down our bank debt. On December 5, 2003, we announced that it is unlikely that we will exercise our option to purchase CenterPoint's holdings of common stock of Texas Genco.

OPPORTUNISTICALLY DIVEST NON-CORE ASSETS

We continuously evaluate our non-core assets. As we demonstrated by the sale of our European energy operations and by the sale of our 588 MW Desert Basin plant operations, we will consider selling specific generation assets in order to narrow our focus, bolster our liquidity and strengthen our financial position.

CAPITALIZE ON UNIQUE OPPORTUNITIES

We will continue to pursue opportunities to enhance our businesses within the parameters of our capital structure. The continued expansion and growth of our residential and small commercial retail energy business in Texas and our large commercial, industrial and institutional retail energy business both in Texas and other strategic markets in the United States also remain top priorities.

EVALUATION OF WHOLESALE ENERGY SEGMENT

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We are engaged in an ongoing evaluation of our wholesale energy businesses, which could lead to decisions to mothball, retire or dispose of assets. In October 2003, we elected to retire five generation units representing a total of 614 MW and, in November 2003, we elected to mothball an additional four generation units representing a total of 824 MW. Additionally, in November 2003, we retired two generation units having 197 MW of net generating capacity to allow continued construction of replacement capacity (522 MW) at the facility. It is possible that we may retire or mothball additional assets, although to date, we have not reached a decision to do so for any other generating assets of our wholesale energy segment.

* * *

Our principal executive offices are located at 1000 Main Street, Houston, Texas 77002, and our telephone number is (713) 497-3000.

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CORPORATE STRUCTURE AND COMPONENTS OF DEBT

The following simplified diagram presents our general corporate structure and the components of our banking and credit facilities and other long-term debt to third parties of Reliant Resources and its subsidiaries (excluding our European energy discontinued operations) as of September 30, 2003 (in millions):

(DEBT STRUCTURE CHART)

- (1) In addition, as of September 30, 2003, Reliant Resources had letters of credit outstanding of \$407 million supporting the Reliant Energy Seward, LLC tax-exempt debt.
- (2) As of September 30, 2003, we had posted cash of \$83 million and letters of credit of \$424 million relating to commercial activities.
- (3) Includes \$272 million in a restricted escrow account. Such funds may be used for possible acquisition of CenterPoint's holdings of the common stock of Texas Genco. On December 5, 2003, we announced that it is unlikely that we will exercise our option to purchase CenterPoint's holdings of common stock of Texas Genco.
- (4) Debt acquired in the Orion Power acquisition was adjusted to fair market value as of the acquisition date. Included in this amount is \$68 million of fair value adjustments related to the Orion Power senior notes.

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- (5) Interest rate swaps acquired in the Orion Power acquisition were adjusted to fair market value as of the acquisition date. Included in the Orion MidWest and Orion NY debt amounts are \$29 million and \$20 million, respectively, related to the fair value adjustments of the interest rate swaps.

- (6) Included in Orion MidWest is restricted cash of \$72 million and \$2 million held by Orion Power Capital, LLC and Orion Power Operating Services Midwest, Inc., respectively. Included in Orion NY is restricted cash of \$3 million, \$2 million and \$2 million held by Orion Power Capital, LLC, Orion Power Operating Services Astoria, Inc. and Orion Power Operating Services Coldwater, Inc., respectively. Included in Liberty is restricted cash of \$1 million held by Orion Power Operating Services MidAtlantic, Inc. Such cash is restricted pursuant to the applicable subsidiaries' credit agreements.

- (7) Includes an aggregate of 13 generation facilities located in the states of California, Nevada, Florida, Illinois, Pennsylvania and Mississippi.

- (8) In August 2000, we entered into separate sale/leaseback transactions with each of the three owner-lessors for our interests in three generating stations acquired in the REMA acquisition. For additional discussion of these lease transactions, see note 14(a) to our consolidated financial statements incorporated by reference herein.

- (9) We have a receivables facility arrangement with financial institutions to sell an undivided interest in accounts receivable from our retail energy segment electric customers on an ongoing basis. Pursuant to this receivables facility, we formed a QSPE as a bankruptcy remote indirect subsidiary of RERH. For additional information regarding this transaction, see note 14 to our interim financial statements incorporated by reference herein.

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THE OFFERING

Issuer.....	Reliant Resources, Inc.
Notes Offered.....	\$275,000,000 in aggregate principal amount of 5.00% Convertible Senior Subordinated Notes due 2010 issued as of July 2, 2003.
Maturity.....	August 15, 2010.
Interest Payment Dates.....	Interest on the notes is payable semi-annually on February 15 and August 15 of each year, commencing August 15, 2003.
Conversion.....	The notes are convertible at the option of the holder into shares of our common stock at a conversion rate of 104.8108 shares of common stock per \$1,000 in principal amount of notes. This is equivalent to a conversion price of

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approximately \$9.54 per share. The conversion rate is subject to adjustment in certain events. The notes are convertible at the above conversion rate at any time on or after issuance and prior to the close of business on the maturity date, unless we have previously redeemed or repurchased the notes. Holders of notes called for redemption or submitted for repurchase will be entitled to convert the notes up to the close of business on the business day immediately preceding the date fixed for redemption or repurchase, as the case may be. See "Description of Notes -- Conversion Rights".

Subordination..... The notes are subordinated to our existing and future senior debt including the senior secured notes. As of September 30, 2003, the aggregate amount of Reliant Resources' outstanding debt was approximately \$4.6 billion and Reliant Resources had approximately \$1.1 billion of commitments that would have been available for future borrowings as senior debt. As of September 30, 2003, the aggregate amount of indebtedness and other liabilities of our subsidiaries was approximately \$5.6 billion (excluding \$1.9 billion related to our European energy operations and our Desert Basin plant operations) and our subsidiaries had approximately \$52 million (excluding \$181 million related to our European energy operations) of commitments that would have been available for future borrowings as senior debt. We will not be restricted under the indenture from incurring senior debt or other additional indebtedness. See "Description of Notes -- Subordination".

Global Note; Book-entry System..... The notes were issued only in fully registered form without interest coupons and in minimum denominations of \$1,000 and integral multiples of \$1,000. The notes are evidenced by one or more global notes deposited with the trustee for the notes, as custodian for DTC. Beneficial interests in the global note are shown on, and transfers of those beneficial interest can only be made through, records maintained by DTC and its direct and indirect participants. See "Description of Notes -- Form, Denomination, Transfer, Exchange and Book-Entry Procedures".

Optional Redemption by Reliant Resources..... We may redeem the notes at our option at any time on or after August 20, 2008, in whole or in part, if the last reported sale price of our common stock is at least 125% of the then effective

conversion price for at least 20 trading days within a period of 30 consecutive trading days ending on the trading day before the date of the redemption notice at the redemption prices set forth below under "Description of Notes -- Optional Redemption by RRI," plus accrued and unpaid interest to, but excluding, the redemption date. We will therefore be required to make at least ten interest payments on the notes before being able to redeem the notes.

Repurchase at Option of
Holders Upon a Change in
Control.....

Upon a change in control, you will have the right to require us to repurchase all or part of your notes at 100% of the principal amount of the notes, plus accrued and unpaid interest to, but excluding, the repurchase date. The repurchase price is payable in cash, or, at our option, in shares of common stock, or other applicable securities if we are not the surviving corporation of the change in control transaction or transactions, valued at 95% of the average closing prices of our common stock or other applicable securities for the five trading days immediately preceding the second trading day prior to the repurchase date, subject to certain conditions. See "Description of Notes -- Repurchase at Option of Holders Upon a Change in Control".

Events of Default.....

The following are events of default under the indenture for the notes:

- we fail to pay principal of or any premium, if any, on any note when due, whether or not the payment is prohibited by the subordination provisions of the indenture;
- we fail to pay any interest, including any special interest, on any note when due, which failure continues for 30 days, whether or not the payment is prohibited by the subordination provisions of the indenture;
- we fail to comply with the notice and repurchase provisions described under "Description of the Notes -- Repurchase at Option of Holders Upon a Change of Control", which failure continues for 30 days following notice whether or not the notice or repurchase is prohibited by the subordination provisions of the indenture;
- we fail to perform any agreement or other covenant in the notes or the indenture, which failure continues for 90 days following notice as provided in the indenture;

- we fail to pay any indebtedness under any bond, debenture, note or other evidence of indebtedness for money borrowed by us or any of our subsidiaries other than RECE and its subsidiaries, Reliant Energy Channelview, L.P. and its subsidiaries so long as, taken together, they would not constitute a significant subsidiary, Liberty Electric PA, LLC, Liberty Electric Power, LLC and their respective subsidiaries so long as, taken together, they would not constitute a significant subsidiary and Reliant Energy Retail Holdings, LLC or any subsidiary thereof in connection with a securitization transac-

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tion in which the indebtedness incurred by such entities is non-recourse to Reliant Resources and its other subsidiaries (or the payment of which is guaranteed by us) in a principal aggregate amount then outstanding in excess of \$100,000,000 at final maturity (either at its stated maturity or upon acceleration);

- failure by Reliant Resources or any of our subsidiaries other than RECE and its subsidiaries, Reliant Energy Channelview, L.P. and its subsidiaries so long as, taken together, they would not constitute a significant subsidiary, Liberty Electric PA, LLC, Liberty Electric Power, LLC and their respective subsidiaries so long as, taken together, they would not constitute a significant subsidiary and Reliant Energy Retail Holdings, LLC or any subsidiary thereof that has engaged in a securitization transaction to pay final and non-appealable judgments aggregating in excess of \$100,000,000, which are not covered by indemnities or third-party insurance, which judgments are not paid, discharged or stayed for a period of 60 days; and
- certain events of bankruptcy, insolvency or reorganization involving us or any of our significant subsidiaries (other than RECE and its subsidiaries).

See "Description of Notes -- Events of Default".

Trading.....

The notes sold to qualified institutional buyers are eligible for trading in the PORTAL market; however, the notes resold pursuant to this prospectus will no longer trade on the PORTAL market. We do not intend to list the notes on any national securities exchange or the Nasdaq National Market.

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Listing of Common Stock..... Our common stock is quoted on The New York Stock Exchange under the symbol "RRI".

Use of Proceeds..... We will not receive any of the proceeds from the sale by any selling securityholder of the notes or shares of common stock offered under this prospectus.

Common Shares..... As of December 5, 2003, there were 294,591,650 shares of our common stock issued and outstanding, excluding 5,212,350 shares held by us as treasury stock.

SUMMARY SELECTED FINANCIAL DATA

The following tables present our summary selected consolidated financial data for 1998 through 2002 and the nine months ended September 30, 2002 and September 30, 2003. The financial data for 1998, 1999 and 2000 are derived from the consolidated historical financial statements of CenterPoint. The financial data for 2001 and 2002 are derived from our audited financial statements. The financial data for the nine months ended September 30, 2002 and September 30, 2003 are derived from our unaudited interim consolidated financial statements. The data set forth below should be read together with our historical consolidated financial statements and the notes to those statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations" for the three years ended December 31, 2000, 2001 and 2002 included in our Current Report on Form 8-K filed on November 14, 2003, incorporated by reference herein, and our interim consolidated financial statements and the notes to those statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations" for the nine months ended September 30, 2002 and 2003 included in our Quarterly Report on Form 10-Q filed on November 12, 2003, incorporated by reference herein. The historical financial information may not be indicative of our future performance and the historical financial information for 1998, 1999 and 2000 does not reflect what our financial position and results of operations would have been had we operated as a separate, stand-alone entity during the periods presented.

	YEAR ENDED DECEMBER 31,				
	1998 (1) (4)	1999 (1) (4)	2000 (1) (4) (5)	2001 (1) (2) (4) (5)	2002 (1) (3) (4)
	(IN MILLIONS, EXCEPT PER SHARE AMOUNT)				
INCOME STATEMENT DATA:					
Revenues.....	\$277	\$601	\$2,732	\$5,499	\$10,577
Trading margins.....	33	88	198	378	288

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Total.....	310	689	2,930	5,877	10,865
Expenses:					
Fuel and cost of gas sold.....	102	293	911	1,576	1,082
Purchased power.....	13	149	926	2,498	7,421
Accrual for payment to CenterPoint.....	--	--	--	--	128
Operation and maintenance.....	65	128	336	461	786
General, administrative and development.....	78	94	270	471	635
Wholesale energy goodwill impairment.....	--	--	--	--	--
Depreciation and amortization....	15	23	118	170	368
Total.....	273	687	2,561	5,176	10,420
Operating income (loss).....	37	2	369	701	445
Other income (expense):					
Gains (losses) from investments.....	--	14	(22)	23	(23)
(Loss) income of equity investments of unconsolidated subsidiaries.....	(1)	(1)	43	7	18
Gain on sale of development project.....	--	--	18	--	--
Other, net.....	1	1	--	2	23
Interest expense.....	(2)	--	(7)	(16)	(267)
Interest income.....	1	1	16	22	28
Interest income (expense) -- affiliated companies, net.....	2	(6)	(172)	12	5
Total other income (expense)...	1	9	(124)	50	(216)
Income (loss) from continuing operations before income taxes...	38	11	245	751	229
Income tax expense.....	17	6	102	290	106
Income (loss) from continuing operations.....	21	5	143	461	123
Income (loss) from discontinued operations before income taxes.....	--	15	73	83	(341)
Income tax (benefit) expense.....	--	(4)	(7)	(16)	108
Income (loss) from discontinued operations.....	--	19	80	99	(449)
Income (loss) before cumulative effect of accounting changes.....	21	24	223	560	(326)
Cumulative effect of accounting changes, net of tax.....	--	--	--	3	(234)
Net income (loss).....	\$ 21	\$ 24	\$ 223	\$ 563	\$ (560)

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	YEAR ENDED DECEMBER 31,					
	1998 (1) (4)	1999 (1) (4)	2000 (1) (4) (5)	2001 (1) (2) (4) (5)	2002 (1) (3) (4)	(1)
	(IN MILLIONS, EXCEPT PER SHARE AMOUNT)					
BASIC EARNINGS (LOSS) PER SHARE:						
Income (loss) from continuing operations.....				\$ 1.66	\$ 0.43	
Income (loss) from discontinued operations, net of tax.....				0.36	(1.55)	
Income (loss) before cumulative effect of accounting changes...				2.02	(1.12)	
Cumulative effect of accounting changes, net of tax.....				.01	(0.81)	
Net income (loss).....				\$ 2.03	\$ (1.93)	
DILUTED EARNINGS (LOSS) PER SHARE:						
Income (loss) from continuing operations.....				\$ 1.66	\$ 0.42	
Income (loss) from discontinued operations, net of tax.....				0.36	(1.54)	
Income (loss) before cumulative effect of accounting changes...				2.02	(1.12)	
Cumulative effect of accounting changes, net of tax.....				.01	(0.80)	
Net income (loss).....				\$ 2.03	\$ (1.92)	

	YEAR ENDED DECEMBER 31,					NINE MONTHS SEPTEMBER
	1998 (1)	1999 (1)	2000 (1) (5)	2001 (1) (2) (5)	2002 (1) (3)	2002 (1)
	(IN MILLIONS, EXCEPT OPERATING DATA AND RATIO)					
STATEMENT OF CASH FLOW DATA:						
Cash flows from operating activities.....	\$ (2)	\$ 38	\$ 335	\$ (152)	\$ 519	\$ 272
Cash flows from investing activities.....	(365)	(1,406)	(3,013)	(838)	(3,486)	(3,302)
Cash flows from financing activities.....	379	1,408	2,721	1,000	3,981	4,291
OTHER OPERATING DATA:						
Capital expenditures.....	(31)	(293)	(747)	(728)	(640)	(455)

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Trading and marketing activity(7):						
Natural gas (Bcf) (8).....	1,115	1,481	2,273	3,265	3,449	2,925
Power sales (thousand MWh) (8).....	61,195	128,266	125,971	222,907	306,425	244,332
Power generation activity:						
Wholesale power sales (thousand MWh) (8).....	2,973	10,204	39,300	62,825	128,588	105,161
Retail power sales (GWh).....	--	--	--	473	62,455	48,379
Net power generation capacity at end of period (MW).....	3,800	4,469	9,231	10,521	19,300	19,888
Ratio of earnings to fixed Charges (9) (10) (11).....	19.31	1.28	1.83	7.50	1.55	2.92

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	DECEMBER 31,					SEPTEMBER 20
	1998 (1)	1999 (1)	2000 (1) (5)	2001 (1) (5)	2002 (1) (5)	2003 (1) (5)
	(IN MILLIONS)					
BALANCE SHEET DATA:						
Property, plant and equipment, net.....	\$ 270	\$ 592	\$ 2,217	\$ 2,796	\$ 6,991	\$ 6,991
Total assets.....	1,409	5,624	13,475	11,726	17,669	17,669
Short-term borrowings.....	--	--	--	92	669	669
Long-term debt to third parties, including current maturities.....	--	69	260	297	6,159	6,159
Accounts and notes (payable) receivable -- affiliated companies, net.....	(17)	(1,333)	(1,967)	445	--	--
Stockholders' equity.....	652	741	2,345	5,984	5,653	5,653

(1) Our results of operations include the results of the following acquisitions, all of which were accounted for using the purchase method of accounting, from their respective acquisition dates: the five generating facilities in California substantially acquired in April 1998, a generating facility in Florida acquired in October 1999, the REMA acquisition that occurred in May 2000 and the Orion Power acquisition that occurred in February 2002. See note 5 to our consolidated financial statements incorporated by reference herein for further information about the acquisitions occurring in 2000 and 2002. In October 1999, we acquired REPGb, which is part of our European energy operations. In February 2003, we signed an agreement to sell our European energy operations to Nuon. In the first quarter of 2003, we began to report the results of our European energy operations as discontinued operations in accordance with SFAS No. 144 and accordingly, reclassified prior period amounts. Also, in July 2003, we entered into a definitive agreement to sell our Desert Basin plant and have reflected those operations as discontinued and accordingly have reclassified prior periods. For further discussion of the sales, see notes

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17 and 18 to our interim financial statements incorporated by reference herein.

- (2) Effective January 1, 2001, we adopted SFAS No. 133 which established accounting and reporting standards for derivative instruments. See note 7 to our consolidated financial statements incorporated by reference herein for further information regarding the impact of the adoption of SFAS No. 133.
- (3) During the third quarter of 2002, we completed the transitional impairment test for the adoption of SFAS No. 142 on our consolidated financial statements, including the review of goodwill for impairment as of January 1, 2002. Based on this impairment test, we recorded an impairment of our European energy segment's goodwill of \$234 million, net of tax, as a cumulative effect of accounting change. See note 6 to our consolidated financial statements incorporated by reference herein for further discussion.
- (4) Beginning with the quarter ended September 30, 2002, we now report all energy trading and marketing activities on a net basis in the statements of consolidated operations. Comparative financial statements for prior periods have been reclassified to conform to this presentation. See note 2(t) to our consolidated financial statements incorporated by reference herein for further discussion.
- (5) As described in note 1 to our consolidated financial statements incorporated by reference herein, our consolidated financial statements for 2000 and 2001 have been restated from amounts previously reported. The restatement had no impact on previously reported consolidated cash flows.
- (6) During the nine months ended September 30, 2003, we recorded a charge of \$985 million (pre-tax and after tax) related to an impairment of goodwill in our wholesale energy reporting unit. See note 7 to our interim financial statements incorporated by reference herein for discussion.
- (7) Excludes financial transactions.
- (8) Includes physical contracts not delivered.
- (9) For purposes of calculating the ratio of earnings to fixed charges, earnings consist of income (loss) from continuing operations before income taxes less (a) (1) income of equity investments of unconsolidated subsidiaries and (2) capitalized interest plus (b) (1) loss of equity investments of unconsolidated subsidiaries, (2) fixed charges, (3) amortization of capitalized interest and (4) distributed income of equity investees. Fixed charges consist of (a) interest expense, (b) interest expense -- affiliated companies, net, (c) capitalized interest and (d) interest within rent expense.
- (10) For the nine months ended September 30, 2003, our earnings were

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insufficient to cover our fixed charges by \$837 million as fixed charges were \$481 million and our loss was \$356 million.

- (11) The pro forma ratios of earnings to fixed charges for the year ended December 31, 2002 and for the nine months ended September 30, 2003 for the issuance of the notes and the senior secured notes did not change from the historical ratios by more than 10% since the specific debt that was repaid with the issuance of the senior secured notes has only been outstanding since March 31, 2003. However, had we assumed the notes and the senior secured notes had been issued and outstanding as of January 1, 2002, and had repaid debt, with the amount of the net proceeds from the senior secured notes, that was in place prior to our March 31, 2003 refinancing, our fixed charges would have increased by \$96 million and \$32 million for the year ended December 31, 2002 and the nine months ended September 30, 2003, respectively. In addition, our ratio of earnings to fixed charges would have been 1.22 for the year ended December 31, 2002 and our earnings would have been insufficient to cover our fixed charges by \$869 million for the nine months ended September 30, 2003.

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RISK FACTORS

Prospective investors should carefully consider the following information in conjunction with the other information in this prospectus and the documents incorporated by reference.

RISKS RELATED TO OUR RETAIL ENERGY OPERATIONS

WE MAY LOSE A SIGNIFICANT NUMBER OF OUR RETAIL RESIDENTIAL AND SMALL COMMERCIAL CUSTOMERS IN THE HOUSTON METROPOLITAN AREA.

In June 1999, the Texas legislature adopted the Texas electric restructuring law, which substantially amended the regulatory structure governing electric utilities in Texas in order to allow full retail competition. Beginning in 2002, all classes of Texas customers of most investor-owned electric utilities, and those of any municipal utility and electric cooperative that opted to participate in the competitive marketplace, were able to choose their retail electric provider. In January 2002, we began to provide retail electric services to all customers of CenterPoint who did not take action to select another retail electric provider. As an affiliated retail electric provider, we are initially required to sell electricity to these Houston area residential and small commercial customers at a specified price, or price to beat, whereas other retail electric providers will be allowed to sell electricity to these customers at any price. We are not permitted to offer electricity to these customers at a price other than the price to beat until January 2005, unless before that date the PUCT determines that 40% or more of the amount of electric power that was consumed in 2000 by the relevant class of customers in the Houston metropolitan area is being provided by retail electric providers other than us. Because we are not able to compete for residential and small commercial customers on the basis of price in the Houston area, we may lose a significant number of these customers to other providers.

WE MAY LOSE A SIGNIFICANT PORTION OF OUR MARKET SHARE OF LARGE COMMERCIAL, INDUSTRIAL AND INSTITUTIONAL CUSTOMERS IN TEXAS.

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We are providing commodity services to the large commercial, industrial and institutional customers previously served by CenterPoint who did not take action to contract with another retail electric provider. In addition, we have signed contracts to provide electricity and energy efficiency services to large commercial, industrial and institutional customers, both in the Houston area, as well as in other parts of the ERCOT Region. We or any other retail electric provider can provide services to these customers at any negotiated price. The market for these customers is very competitive, and any of these customers that selects us to be their provider may subsequently decide to switch to another provider at the conclusion of the term of their contract with us.

THE RESULTS OF OUR RETAIL ELECTRIC OPERATIONS IN TEXAS ARE LARGELY DEPENDENT UPON THE AMOUNT OF HEADROOM AVAILABLE IN OUR PRICE TO BEAT. FUTURE ADJUSTMENTS TO THE PRICE TO BEAT MAY BE INADEQUATE TO COVER OUR COSTS TO PURCHASE POWER TO SERVE OUR RESIDENTIAL AND SMALL COMMERCIAL CUSTOMERS.

The results of our residential and small commercial retail electric operations in Texas are largely dependent upon the amount of headroom available in our price to beat. Headroom may be a positive or negative number. The PUCT's current regulations allow us to request an adjustment of our fuel factor based on the percentage change in the forward price of natural gas or as a result of changes in the price of purchased energy up to twice a year. As part of a request to change the fuel factor for changes in purchased energy prices, we would have to show that the fuel factor must be adjusted to restore the amount of headroom that existed at the time the initial price to beat fuel factor was set by the PUCT. We cannot estimate with any certainty the magnitude and frequency of the adjustments required, if any, and the eventual impact of such adjustments on the amount of headroom available in our price to beat. If this adjustment and any future adjustments to our price to beat are inadequate to cover future increases in our costs to purchase power to serve our price to beat customers or are delayed by the PUCT, our business, results of operations, financial condition and cash flows could be materially adversely affected.

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In March 2003, the PUCT approved a revised price to beat rule. The changes from the previous rule include an increase in the number of days used to calculate the natural gas price average from 10 trading days to 20 trading days, and an increase in the threshold of what constitutes a significant change in the market price of natural gas and purchased energy from 4% to 5%, except for filings made after November 15th of a given year that must meet a 10% threshold. The revised rule also provides that the PUCT will, after reaching a determination of stranded costs in 2004, make downward adjustments to the price to beat fuel factor if natural gas prices drop below the prices embedded in the then-current price to beat fuel factor. In addition, the revised rule also specifies that the base rate portion of the price to beat will be adjusted to account for changes in the non-bypassable rates that result from the utilities' final stranded cost determination in 2004. Adjustments to the price to beat will be made following the utilities' final stranded cost determination in 2004. At this time, we cannot predict the impact of the changes on our financial condition or results of operations. In March 2003, the PUCT approved our request to increase the price to beat fuel factor for residential and small commercial customers based on a 23.4% increase in the price of natural gas from our previous increase in December 2002. In July 2003 our second and final request for 2003 was approved by the PUCT to increase the price to beat fuel factor based on a 23.1% increase in the price of natural gas. Our requested increase was based on an average forward 12-month natural gas price of \$6.1000/MMbtu during the twenty-day trading period beginning May 14, 2003 and ending June 11,

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2003. The requested increase represents an increase of 9.2% in the total bill of a residential customer using, on average, 12,000 kilowatt hours per year.

On June 26, 2003, CenterPoint petitioned the PUCT to request immediate elimination of the transmission and distribution utility's excess mitigation credits (EMC). EMC are credits against the transmission and distribution utility's non-bypassable charges to retail electric providers providing service in CenterPoint's territory. On August 6, 2003, the staff of the PUCT filed a recommendation that the PUCT dismiss CenterPoint's petition because it does not comply with the procedure set out in the statute for addressing the issues raised. Subsequently, the procedural schedule was suspended. We, along with a number of other parties, are currently engaged in settlement discussions on this issue and other outstanding issues that CenterPoint currently has before the PUCT. It is not known at this time what the ultimate outcome from this proceeding will be and whether the PUCT will grant, deny or take other action with respect to CenterPoint's petition. If CenterPoint's request is granted and there is no corresponding increase in the price to beat rate, there could be a material adverse impact on our financial condition, results of operations and cash flows.

WE FACE STRONG COMPETITION FROM AFFILIATED RETAIL ELECTRIC PROVIDERS OF INCUMBENT ELECTRIC UTILITIES AND OTHER COMPETITORS OUTSIDE OF HOUSTON.

In most retail electric markets outside the Houston area, our principal competitor is the local incumbent electric utility company's retail affiliate. These retail affiliates have the advantage of long-standing relationships with their customers. In addition to competition from the incumbent electric utilities' affiliates, we face competition from a number of other retail electric providers, including affiliates of other non-incumbent electric utilities, independent retail electric providers and, with respect to sales to large commercial, industrial and institutional customers, independent power producers and wholesale power providers acting as retail electric providers. Some of these competitors are larger and better capitalized than we are.

OUR RETAIL ENERGY OPERATIONS ARE SUBJECT TO EXTENSIVE MARKET OVERSIGHT. CHANGES TO MARKET PROTOCOLS OR NEW REGULATION COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, RESULTS OF OPERATIONS, FINANCIAL CONDITION AND CASH FLOWS.

The ERCOT ISO, which oversees the ERCOT Region, has and may continue to modify the market structure and other market mechanisms in an attempt to improve market efficiency. Moreover, existing regulations may be revised or reinterpreted and new laws and regulations may be adopted or become applicable to our commercial activities. These actions could have a material adverse effect on our results of operations, financial condition and cash flows.

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PAYMENT DEFAULTS BY AND LITIGATION WITH OTHER RETAIL ELECTRIC PROVIDERS TO ERCOT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, RESULTS OF OPERATIONS, FINANCIAL CONDITION AND CASH FLOWS.

In the event of a default by a retail electric provider of its payment obligations to ERCOT, the portion of the obligation that is unrecoverable by ERCOT from the defaulting retail electric provider is assumed by the remaining market participants in proportion to each participant's load ratio share. As a retail electric provider and market participant in ERCOT, we would pay a portion of the amount owed to ERCOT should such a default occur, and ERCOT is not

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successful in recovering such amounts. The default of a retail electric provider in its obligations to ERCOT could have a material adverse effect on our business, results of operations, financial condition and cash flows.

In March 2003, TCE, a retail electricity provider in the ERCOT market, filed for bankruptcy protection. The bankruptcy court has approved TCE's treatment of ERCOT's claim, which provides for payments to ERCOT of \$1 million a month beginning in July 2004. From September 15, 2003 until July 15, 2004, TCE will pay ERCOT fifty percent of any prepetition accounts receivable collected, as well as \$25,000 per month. This treatment is also included in TCE's first amended disclosure statement, which is awaiting the approval of the bankruptcy court. No assurance can be given that TCE will be able to satisfy its obligations to ERCOT. For information regarding a lawsuit filed by TCE against ERCOT and several other electricity suppliers for antitrust and other claims, see note 13(a) to our interim financial statements, incorporated by reference herein.

WE ARE HEAVILY DEPENDENT UPON THIRD PARTY PROVIDERS OF CAPACITY AND ENERGY TO SUPPLY OUR RETAIL OBLIGATIONS.

We do not own sufficient generating resources in Texas to supply our retail business. The capacity and energy to supply our retail business is purchased at market prices from a variety of suppliers under contracts with varying terms. Our retail customers are concentrated in the Houston metropolitan area, and there is limited ability to serve these customers with generation located outside the Houston metropolitan area. Texas Genco, located in the Houston congestion zone, is the largest supplier of capacity and energy for our retail business and is likely to remain our largest supplier for the foreseeable future. There is a significant risk that our business, results of operations, financial condition and cash flows could be materially adversely affected if we are not able to purchase the capacity and energy from Texas Genco or otherwise obtain sufficient capacity and energy required to serve our customers. The failure of any of our third party suppliers to perform under the terms of existing or future contracts could have a material adverse effect on our results of operations, financial condition and cash flows.

WE MAY BE REQUIRED TO MAKE A SUBSTANTIAL PAYMENT TO CENTERPOINT IN 2004.

We will be required to make a payment to CenterPoint in 2004 as required by the Texas electric restructuring law, unless on or prior to January 1, 2004, 40% or more of the amount of electric power that was consumed in 2000 by residential or small commercial customers, as applicable, within CenterPoint's Houston service territory is being provided by retail electric providers other than us. This amount will be computed by multiplying \$150 by the number of residential or small commercial customers, as the case may be, that we serve on January 1, 2004 in CenterPoint's Houston service territory, less the number of residential or small commercial electric customers, as the case may be, we serve in other areas of Texas. Currently, we believe it is probable that we will be required to make a payment in the range of \$170 million to \$180 million (pre-tax), with a most probable estimate of \$175 million to CenterPoint related to our residential customers only.

Currently, we believe that the 40% test for small commercial customers will be met and we will not make a payment related to those customers. If the 40% test is not met related to our small commercial customers and a payment is required, we estimate this payment would be approximately \$30 million.

WE RELY ON THE INFRASTRUCTURE OF TRANSMISSION AND DISTRIBUTION UTILITIES AND THE ERCOT ISO TO TRANSMIT AND DELIVER ELECTRICITY TO OUR RETAIL CUSTOMERS AND TO OBTAIN INFORMATION ABOUT OUR RETAIL CUSTOMERS. IN ADDITION, WE RELY ON THE RELIABILITY OF OUR OWN INFRASTRUCTURE AND SYSTEMS TO PERFORM ENROLLMENT AND BILLING FUNCTIONS. ANY INFRASTRUCTURE FAILURE COULD NEGATIVELY IMPACT OUR CUSTOMERS' SATISFACTION AND COULD HAVE A MATERIAL NEGATIVE IMPACT ON OUR EARNINGS.

We are dependent on transmission and distribution utilities for maintenance of the infrastructure through which we deliver electricity to our retail customers. Any infrastructure failure that interrupts or impairs delivery of electricity to our customers could negatively impact the satisfaction of our customers with our service and could have a material adverse effect on our results of operations, financial condition and cash flow. Additionally, we are dependent on the transmission and distribution utilities for performing service initiations and changes, and for reading our customers' energy meters. We are required to rely on the transmission and distribution utility or, in some cases, the ERCOT ISO, to provide us with our customers' information regarding energy usage, and we may be limited in our ability to confirm the accuracy of the information. The provision of inaccurate information or delayed provision of such information by the transmission and distribution utilities or the ERCOT ISO could have a material adverse effect on our business, results of operations, financial condition and cash flow. In addition, any operational problems with our new systems and processes could similarly have a material adverse effect on our business, results of operations, financial condition and cash flow. For additional information, see "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Retail Energy" for the three years ended December 31, 2000, 2001 and 2002 and for the nine months ended September 30, 2002 and 2003, incorporated by reference herein.

THE ERCOT ISO HAS EXPERIENCED A NUMBER OF PROBLEMS WITH ITS INFORMATION SYSTEMS SINCE THE ADVENT OF COMPETITION IN THE TEXAS MARKET THAT HAVE RESULTED IN DELAYS IN SWITCHING CUSTOMERS AND RECEIVING FINAL SETTLEMENT INFORMATION FOR CUSTOMER ACCOUNTS. OUR OPERATING RESULTS MAY BE ADVERSELY AFFECTED IF THESE PROBLEMS ARE NOT ALLEVIATED.

The ERCOT ISO is the independent system operator responsible for maintaining reliable operations of the bulk electric power supply system in the ERCOT Region and for acting as a central agent for the registration of customers with their chosen retail electric supplier. Its responsibilities include ensuring that information relating to a customer's choice of retail electric provider, including data needed for ongoing servicing of customer accounts, is conveyed in a timely manner to the appropriate parties. Problems in the flow of information between the ERCOT ISO, the transmission and distribution utilities and the retail electric providers have resulted in delays and other problems in enrolling and billing customers. While the flow of information has improved materially over the course of the first year of full market choice operations, remaining system and process problems are still being addressed. When customer enrollment transactions are not successfully processed by all involved parties, ownership records in the various systems supporting the market are not synchronized properly and subsequent transactions for billing and settlement are adversely affected. The impact can include us not being the electric provider-of-record for intended or agreed upon time periods, delays in receiving customer consumption data from the ERCOT ISO that is necessary for billing, as well as the incorrect application of rates or prices and imbalances in our electricity supply and actual sales.

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The ERCOT ISO is also responsible for handling, scheduling and settlement for all electricity supply volumes in the ERCOT Region. The ERCOT ISO plays a vital role in the collection and dissemination of metering data from the transmission and distribution utilities to the retail electric providers. We and other retail electric providers schedule volumes based on forecasts, which are based, in part, on information supplied by the ERCOT ISO. To the extent that these amounts are not accurate or timely, we could have incorrectly estimated our scheduled volumes and supply costs.

The ERCOT ISO volume settlement process has been delayed on several occasions since the opening of the market in order to address operational problems with data management between the ERCOT ISO, the transmission and distribution utilities and the retail electric providers. During the third quarter of 2002, the ERCOT ISO issued true-up settlements for the pilot time period of July 31, 2001 to December 31,

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2001. True-up settlement calculations were then temporarily suspended to allow a threshold level of consumption data for subsequent periods from the transmission and distribution utilities to be loaded into the ERCOT ISO's systems. True-up settlement calculations for the period January 1, 2002 through December 31, 2002 were performed by the ERCOT ISO during the second, third and early fourth quarters of 2003. These settlement calculations indicate that our customers utilized greater volumes of electricity than our records indicate. We are currently pursuing the ERCOT ISO's process for disputing settlement calculations for that time period. True-up settlement calculations for periods after December 31, 2002 are currently suspended while the ERCOT ISO provides the transmission and distribution utilities and retail electric providers with more detailed information on data in the ERCOT ISO's systems that are being used in the settlement calculations. We are working closely with the ERCOT ISO and other market participants to identify and resolve discrepancies that may have impacted settlements already performed as well as future settlements.

The ERCOT ISO fees related to resolving local congestion have increased substantially during 2003. Efforts are ongoing to establish the causes of the fee increases and to correct the market design or systems, if necessary. In addition, we may be billed a larger than expected share of these total fees if the ERCOT ISO's records indicate that our volumes delivered were greater than the volumes our records indicate.

For additional information regarding settlement issues, see "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Retail Energy" for the three years ended December 31, 2000, 2001 and 2002 and for the nine months ended September 30, 2002 and 2003, incorporated by reference herein.

RISKS RELATED TO OUR WHOLESALE ENERGY OPERATIONS

WE MAY BE REQUIRED TO RECORD ADDITIONAL IMPAIRMENTS IN THE RECORDED VALUE OF OUR ASSETS.

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We tested our wholesale energy segment's goodwill for impairment effective July 2003 as required under SFAS No. 142 due to the disposition of our Desert Basin plant operations. In connection with this July 2003 impairment analysis, we recognized an impairment of \$985 million (pre-tax and after-tax) relating to our wholesale energy reporting unit. We plan to perform our annual goodwill impairment tests for our wholesale energy and retail energy reporting units effective November 1, 2003. If actual results of operations are worse than projected or our wholesale energy market outlook changes, we could have additional impairments of goodwill and impairments of our property, plant and equipment in future periods, which, in turn, could have a material adverse effect on our results of operations.

OUR RESULTS OF OPERATIONS, FINANCIAL CONDITION AND CASH FLOWS ARE SUBJECT TO MARKET RISKS, THE IMPACT OF WHICH WE CANNOT FULLY MITIGATE.

As part of our merchant electric generation business, we sell electric energy, capacity and ancillary services and purchase fuel under short and long-term contractual obligations and through various spot markets. We are not guaranteed any rate of return on our capital investments through cost of service rates, and our results of operations, financial condition and cash flows from these businesses are subject to market risks which can be partially mitigated by hedging long-term sales agreements and other management actions. However, a substantial portion of market risk remains beyond our control. These market risks include commodity price risk, counterparty risk, credit risk, transmission risk and competitor actions.

WE RELY ON MARKET LIQUIDITY AND THE ESTABLISHMENT OF VALID PRICING TO PROPERLY MANAGE OUR RISKS.

Our commercial businesses depend on sufficient market participation to establish market liquidity and valid pricing to properly manage the risks inherent in our businesses. The recent reduction in the number of market participants has significantly decreased market liquidity and may impair our ability to manage business risks. In addition, such a reduction may increase our management's reliance on internal models for decision-making. Our internal models may not accurately represent the markets in which we

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participate, potentially causing us to make incorrect decisions. These factors could have a material adverse effect on our results of operations, financial condition and cash flows.

WE MAY NOT BE ABLE TO SATISFY THE GUARANTEES AND INDEMNIFICATION OBLIGATIONS RELATING TO OUR COMMERCIAL ACTIVITIES IF THEY BECOME DUE AT THE SAME TIME.

In connection with our commercial businesses, we guarantee or indemnify the performance of a significant portion of the obligations of certain of our subsidiaries. For example, we routinely guarantee the obligations of Reliant Energy Services and other subsidiaries of ours under substantially all of their gas and electricity trading, marketing and origination contracts. The obligations underlying these guarantees and indemnities are recorded on our consolidated balance sheet as trading and marketing liabilities and non-trading derivative liabilities. These obligations make up a significant portion of these line items. In addition, we have, from time to time, executed guarantees of the obligations of our subsidiaries under leases of real property, financing documents and certain other miscellaneous contracts such as long-term turbine maintenance contracts. Some of these guarantees and indemnities are for fixed amounts, others have a fixed maximum amount and others do not specify a maximum

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amount. If we were unable to successfully negotiate lower amounts or alternative arrangements, we would not be able to satisfy all of these guarantees and indemnification obligations if they were to all come due at the same time. For additional information regarding our guarantees and indemnification obligations, see note 14(f) to our consolidated financial statements incorporated by reference herein.

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

We depend on power transmission and distribution and natural gas transportation facilities owned and operated by utilities and others to deliver energy products to our customers. Our customers in turn either consume these products or deliver them to the ultimate consumer. If transmission or transportation is disrupted, or the capacity is inadequate, our ability to sell and deliver our products may be hindered.

AS A RESULT OF EVENTS IN CALIFORNIA OVER THE PAST FEW YEARS, OUR WHOLESALE POWER OPERATIONS IN OUR WEST REGION HAVE EXPERIENCED DELAYS IN THE COLLECTION OF RECEIVABLES AND ARE SUBJECT TO UNCERTAINTY, INCLUDING POTENTIALLY MATERIAL REFUND OBLIGATIONS, RELATING TO ONGOING LITIGATION AND GOVERNMENTAL PROCEEDINGS RELATING TO OUR ACTIVITIES IN THE ELECTRICITY AND GAS MARKETS.

We are defendants in several class action lawsuits and other lawsuits filed against us and a number of other companies that either owned generation plants in California or sold electricity in California markets. These lawsuits challenge the prices for wholesale electricity in California during parts of 2000 and 2001. For information regarding these and other lawsuits, see notes 13(a) and 13(b) to our interim financial statements incorporated by reference herein.

The FERC has established a refund proceeding to reset the market clearing prices for sales into the Cal ISO and Cal PX spot markets for the period from October 2000 to mid-June 2001. Although this proceeding has not yet concluded, we are likely to have a substantial net refund obligation as a result of this proceeding, which we estimate to be between approximately \$103 million and \$231 million for energy sales in California. For information regarding reserves against receivables, the FERC refund methodology and uncertainty in the California wholesale energy market, see note 13(b) to our interim financial statements incorporated by reference herein.

Several state and other federal regulatory investigations are ongoing in connection with the wholesale electricity and natural gas prices in California and neighboring Western states to determine the causes of the high prices and potentially to recommend remedial action. In July 2003, the City of Los Angeles announced that it had filed suit against us and one of our employees in the United States District Court for the Central District of California. The lawsuit alleges that we conspired to manipulate the price for natural gas in breach of our contract to supply the Los Angeles Department of Water and Power with

natural gas and acted in violation of federal and state antitrust laws, the federal Racketeer Influenced and Corrupt Organization Act and the California False Claims Act. The lawsuit seeks treble damages for the alleged overcharges for gas purchased by the Los Angeles Department of Water and Power of an estimated \$218 million, interest, costs of suit and attorneys' fees.

We may also face more stringent state regulations in the future. There have been efforts in California to repeal deregulation. Also, a new California state statute may give the CPUC authority to regulate the operations of our California generating subsidiaries, beyond the existing state regulation regarding environmental and other health and safety matters. The CPUC has recently initiated the process of establishing the methods through which these new requirements will be administered.

As these investigations proceed, additional matters could be discovered that could result in the imposition of restrictions on our businesses, fines, penalties or other adverse events. Furthermore, as events occur to other companies in the retail and wholesale energy industry that lead to investigations of such companies by regulatory authorities, we may also be investigated by such regulatory authorities if they decide to broaden their investigation to comparable companies in the industry.

OUR WHOLESALE ENERGY SEGMENT IS SUBJECT TO EXTENSIVE MARKET REGULATION. CHANGES IN THESE REGULATIONS COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, RESULTS OF OPERATIONS, FINANCIAL CONDITION AND CASH FLOWS.

The FERC, which has jurisdiction over wholesale power rates, as well as independent system operators that oversee some of these markets, has imposed and may continue to impose price limitations, bidding rules and other mechanisms in an attempt to address some of the price volatility in these markets and mitigate market price fluctuations. These actions, along with potential changes to existing mechanisms, could have a material adverse effect on our results of operations, financial condition and cash flows.

We operate in a regulatory environment that is undergoing significant changes as a result of varying restructuring initiatives at both the state and federal levels. New regulatory policies, which may have a significant impact on our industry, are now being developed and we cannot predict the future direction of these changes or the ultimate effect that this changing regulatory environment will have on our business.

Moreover, existing regulations may be revised or reinterpreted and new laws and regulations may be adopted or become applicable to our facilities or our commercial activities. Such future changes in laws and regulations may have a detrimental effect on our business. In this connection, state officials, the Cal ISO and the investor-owned utilities in California have argued to the FERC that our California generating subsidiaries should not continue to have market-based rate authority. (As discussed further above, in addition to these requests, the FERC has also recently issued a number of "Show Cause" orders against various market participants in the California markets, including a number of Reliant Resources entities. These "Show Cause" orders relate to alleged market manipulation and/or anomalous bidding practices, and could result in either disgorgement of alleged profits or the loss of market-based rate authority for various Reliant Resources entities. The FERC has also initiated an investigation

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into economic withholding allegations that could result in similar remedies.) In the event the market-based rate authority of any Reliant Resources entity is revoked, the FERC has not provided guidance on how cost-based rates might be implemented in a market regime. We cannot predict what actions the FERC may take in the future. The impact of receiving cost-based rates on our California portfolio is also not predictable given that the numerous details of any such implementation are unknown at this time.

In addition to the FERC investigations, several state and other federal regulatory investigations are ongoing in connection with wholesale electricity prices to determine the causes of the high prices and potentially to recommend remedial action. As these investigations proceed, additional matters could be discovered that could result in the imposition of restrictions on our business, fines, penalties or other adverse actions.

The Cal ISO has undertaken, at the FERC's direction, a market redesign process that includes an ongoing obligation to offer available capacity in Cal ISO markets, a \$250 per MWh price cap, as well as

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"automated" mitigation of all bids when any zonal clearing price for balancing energy exceeds \$91.87 per MWh. The automated mitigation is only applied to bids that exceed certain reference prices and that would significantly increase the market price. However, in February 2003, the Cal ISO stated that it intends to appeal in federal court the FERC's decision regarding the application of automated mitigation to local market power situations. While the FERC has adopted similar thresholds for both local and system market power, Cal ISO is seeking to have a more restrictive procedure applied to local market power. Additional features of the California market redesign to be implemented in the future include a revised market monitoring and mitigation structure, a revised congestion management mechanism and an obligation for load-serving entities in California to maintain capacity reserves. A new California state statute purports to give the CPUC new power to regulate the operations and maintenance practices of our California generating subsidiaries, beyond the existing state regulation, regarding environmental and other health and safety matters. The CPUC has recently initiated the process of establishing the methods through which these new requirements will be administered.

The NY Market is subject to significant regulatory oversight and control. The results of our operations in the NY Market are dependent on the continuance of the current regulatory structure. The rules governing the current regulatory structure are subject to change. We cannot assure you that we will be able to adapt our business in a timely manner in response to any changes in the regulatory structure, which could have a material adverse effect on our financial condition, results of operations and cash flows. The primary regulatory risk in this market is associated with the oversight activity of the New York Public Service Commission, the NYISO and the FERC. Our assets located in New York are subject to "lightened regulation" by the New York Public Service Commission, including provisions of the New York Public Service Law that relate to enforcement, investigation, safety, reliability, system improvements, construction, excavation, and the issuance of securities. Because lightened regulation was accomplished administratively, it could be revoked. The NYISO has the ability to revise wholesale prices, which could lead to delayed or disputed collection of amounts due to us for sales of electric energy and ancillary services. The NYISO may in some cases, subject to the FERC approval, also impose cost-based pricing and/or price caps. The NYISO has implemented automated mitigation procedures under which day-ahead energy bids will be automatically reviewed. If bids exceed certain pre-established thresholds and have a significant impact on the market-clearing price, the bids are then reduced to a

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pre-established market-based or negotiated reference bid. The NYISO has also adopted, at the FERC's direction, more stringent mitigation measures for all generating facilities in transmission-constrained New York City.

On June 25, 2003, the FERC announced that it was proposing new rules to prevent market abuse. The rules would prohibit certain transactions and practices under sellers' market-based rate electric tariffs and blanket gas certificates. The new rules relate to market manipulation, communications, reporting and record retention. Under the proposed rules, a seller found to have engaged in prohibited behavior would be subject to disgorgement of unjust profits and non-monetary remedies such as revocation of the seller's market-based rate authority or blanket certificate authority. If the FERC adopts its proposed market behavior rules, our future earnings may be adversely affected by an open-ended refund obligation on sales at market-based rates or under blanket certificate authority to the extent we were determined to have violated the new tariff provisions required by the proposed rule.

The FERC also instituted a SMD rulemaking proceeding that proposes to eliminate discrimination in transmission service and to standardize electricity market design. The FERC's SMD proceeding would establish standardized transmission service throughout the United States, a standard wholesale electric market design, including forward and spot markets for energy and an ancillary services market. Further, this proceeding is also expected to provide all RTOs specifications regarding the entities that administer these markets and how these entities perform market monitoring and mitigation. While we believe SMD is a positive development for our business, significant opposition to SMD has been voiced, and we cannot predict at this time whether SMD will be adopted as proposed or what effect standard market design, in whatever form it may take if and when it is adopted, would have on our business growth prospects and financial results.

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The FERC's RTO initiative, which began in May 1999, is making progress in all areas of the country. If RTOs are established as envisioned by the FERC, "rate pancaking," or multiple transmission charges that apply to a single point-to-point delivery of energy will be eliminated within a region, and wholesale transactions within the region and between regions will be facilitated. The end result could be a more competitive, transparent market for the sale of energy and a more economic and efficient use and allocation of resources. However, considerable opposition exists in some regions of the United States to the development of RTOs as envisioned by the FERC, and the timing for completion of the developing RTOs is uncertain.

Additionally, federal legislative initiatives have been introduced and discussed to address the problems being experienced in some power markets and to enhance or limit the FERC authority. We cannot predict whether such proposals will be adopted or their impact on industry restructuring. If the trend towards competitive restructuring of the wholesale power markets is reversed, discontinued or delayed, the business growth prospects and financial results of our wholesale energy and retail energy segments could be adversely affected.

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

Our wholesale energy segment is subject to extensive environmental regulation by federal, state and local authorities. We are required to comply with numerous environmental laws and regulations, and to obtain numerous governmental permits in operating our facilities, a number of which are

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coal-fired and affected by more numerous and diverse regulations. We may incur significant costs to comply with these requirements. If we fail to comply with these requirements, we could be subject to civil or criminal penalties including fines. Existing environmental regulations can be revised, reinterpreted or become applicable to our facilities, new laws and regulations could be adopted, and future changes in environmental laws and regulations could occur, including potential regulatory and enforcement developments related to air emissions. If any of these events occur, our business, results of operations, financial condition and cash flows could be materially adversely affected. For more information regarding compliance with environmental laws, see "Our Business -- Environmental Matters".

THE MAJORITY OF OUR HYDROELECTRIC FACILITIES ARE REQUIRED TO BE LICENSED UNDER THE FEDERAL POWER ACT. ANY FAILURE TO OBTAIN OR MAINTAIN A REQUIRED LICENSE FOR ONE OR MORE OF OUR HYDROELECTRIC FACILITIES COULD HAVE AN ADVERSE IMPACT ON US.

The Federal Power Act gives the FERC exclusive authority to license non-federal hydroelectric projects on navigable waterways and federal lands. The FERC hydroelectric licenses are issued for terms of 30 to 50 years. Some of our hydroelectric facilities, representing approximately 90 MW of capacity, have licenses that expire within the next ten years. Facilities that we own representing approximately 160 MW of capacity have new or initial license applications pending before the FERC. Upon expiration of a FERC license, the federal government can take over the project and compensate the licensee, or the FERC can issue a new license to either the existing licensee or a new licensee. In addition, upon license expiration, the FERC can decommission an operating project and even order that it be removed from the river at the owner's expense. In deciding whether to issue a license, the FERC gives equal consideration to a full range of licensing purposes related to the potential value of a stream or river. It is not uncommon for the relicensing process to take between four and ten years to complete. Generally, the relicensing process begins at least five years before the license expiration date and the FERC issues annual licenses to permit a hydroelectric facility to continue operations pending conclusion of the relicensing process. We expect that the FERC will issue to us new or initial hydroelectric licenses for all the facilities with pending applications. Presently, there are no applications for competing licenses and there is no indication that the FERC will decommission or order any of the projects to be removed.

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INCREASING COMPETITION IN WHOLESALE POWER MARKETS MAY ADVERSELY AFFECT OUR RESULTS OF OPERATIONS, FINANCIAL CONDITION, CASH FLOWS AND MAY REQUIRE ADDITIONAL LIQUIDITY TO REMAIN COMPETITIVE.

Our wholesale energy segment competes with other energy merchants. In order to successfully compete, we must have the ability to aggregate supplies at competitive prices from different sources and locations and must be able to efficiently utilize transportation services from third-party pipelines and transmission services from electric utilities. We also compete against other energy merchants on the basis of our relative skills, financial position and access to credit sources. Energy customers, wholesale energy suppliers and transporters often seek financial guarantees and other assurances that their energy contracts will be satisfied. If price information becomes increasingly available in the energy marketing and trading business, we anticipate that our operations will experience greater competition and downward pressure on per-unit profit margins. In addition, our merchant asset business is constrained by our liquidity, our access to credit and the reduction in market liquidity. Other companies with which we compete may not have similar constraints.

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OUR BUSINESS OPERATIONS AND HEDGING ACTIVITIES EXPOSE US TO THE RISK OF NON-PERFORMANCE BY COUNTERPARTIES.

Our trading, marketing and risk management services operations are exposed to the risk that counterparties who owe us money or physical commodities and services, such as power, natural gas or coal, will not perform their obligations. Should the counterparties to these arrangements fail to perform, we might be forced to acquire alternative hedging arrangements or replace the underlying commitment at then-current market prices. In this event, we might incur additional losses to the extent of amounts, if any, already paid to the counterparties.

As a result of recent events, including the credit crisis in the merchant energy sector, the bankruptcy filings of NRG Energy Inc., National Energy & Gas Transmission, Inc. and Mirant Corp., the decreasing liquidity in our trading markets and the related downgrading of our credit ratings and the credit ratings of many of our trading counterparties to below investment grade, we have been required to enter into trading and other commercial arrangements with higher risk counterparties than those with whom we have typically contracted in the past. These arrangements, coupled with the credit crisis in our sector, have increased our exposure to the risk of non-performance by counterparties who owe us money or physical commodities.

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

Our wholesale energy segment is exposed to risks relating to the breakdown or failure of equipment or processes, fuel supply interruptions, shortages of equipment, material and labor, and operating performance below expected levels of output or efficiency. Significant portions of our facilities were constructed many years ago. Older generating equipment, even if maintained in accordance with good engineering practices, may require significant capital expenditures to add to or upgrade equipment to keep it operating at peak efficiency, to comply with changing environmental requirements, or to provide reliable operations. Such changes could affect our operating costs. Any unexpected failure to produce power, including failure caused by breakdown or forced outage, could have a material adverse effect on our results of operations, financial condition and cash flows.

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CONSTRUCTION OF POWER GENERATION FACILITIES INVOLVES SIGNIFICANT SCHEDULE AND COST RISKS THAT COULD NEGATIVELY AFFECT OUR RESULTS OF OPERATIONS, FINANCIAL CONDITION AND CASH FLOWS.

Currently, we have one power generation facility, and a replacement or incremental electric power generation unit at an existing facility, under construction. Our successful completion of these facilities is subject to the following:

- power prices;
- shortages and inconsistent qualities of equipment, material and labor;
- availability of financing;

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- failure of key contractors and vendors to fulfill their obligations;
- work stoppages due to plant bankruptcies and contract labor disputes;
- permitting and other regulatory matters;
- unforeseen weather conditions;
- unforeseen equipment problems;
- environmental and geological conditions; and
- unanticipated capital cost increases.

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

In addition, construction delays and contractor performance shortfalls can result in the loss of revenues and may, in turn, adversely affect our results of operations. At our Seward power plant, one of our facilities under construction, a sub-contractor of one of our two main contractors at the plant, after a dispute with such main contractor, has filed a mechanics lien against the property to secure payment of the amount of their fees and damages, which the subcontractor alleges to be \$36 million. These fees are disputed. The failure to complete construction according to specifications at this plant and our other facilities under construction can result in liabilities, reduced plant efficiency, higher operating costs and reduced earnings.

THE RECENT TERMINATION OF THE TOLLING AGREEMENT FOR OUR LIBERTY ELECTRIC GENERATING STATION AND/OR A POTENTIAL FORECLOSURE BY THE LIBERTY LENDERS COULD HAVE A MATERIAL ADVERSE IMPACT ON OUR RESULTS OF OPERATIONS, FINANCIAL CONDITION AND CASH FLOWS.

One of our subsidiaries owns a 530 MW combined cycle gas fired power generation facility (the Liberty generating station). Liberty financed substantially all of the construction costs of the Liberty generating station through borrowings under a credit agreement of which \$262 million was outstanding as of September 30, 2003. Borrowings under the Liberty credit agreement, which are non-recourse to Reliant Resources and its affiliates (other than LEP and Liberty), are secured by pledges of, among other things, the assets of the Liberty generating station, including a tolling agreement for the purchase and sale of all of the electric energy, capacity and ancillary services of the station which was terminated effective as of July 8, 2003.

In July 2003, the counterparty under the tolling agreement, and one of its corporate guarantors, filed for reorganization under Chapter 11 of the United States Bankruptcy Code. In August 2003, the federal bankruptcy court issued an order rejecting the tolling agreement, which had the effect of terminating it, effective retroactively to July 8, 2003. The bankruptcy filing and the related termination of the tolling agreement constitute an event of default under the

Liberty credit agreement. As a result, Liberty's lenders

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are currently entitled to control disbursement of funds by Liberty, accelerate the maturity date of the debt of the Liberty credit agreement and/or foreclose upon the lenders' security interests in Liberty's assets. In addition, as a result of the termination of the tolling agreement, and in light of current market conditions, Liberty does not expect to have sufficient cash flow to pay all of its expenses and to post the collateral required to buy fuel or in respect of the gas transportation agreements, and, at the same time, meet debt service obligations.

An event of default under the Liberty credit agreement does not constitute an event of default under any other debt agreements of Reliant Resources or its affiliates. Likewise, a bankruptcy or reorganization of Liberty would not constitute an event of default under the debt agreements of Reliant Resources or its affiliates. If, however, the lenders foreclose on the Liberty generating station, we could incur a pre-tax loss of an amount up to our recorded net book value, with the potential of an additional loss due to an impairment of goodwill to be allocated to LEP, as a result of