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Joan Claybrook, President

July 28, 2004

Kenneth D. Schisler, Chairman
Public Service Commission
6 St. Paul St., 16th Floor
Baltimore, MD 21202

Dear Chairman Schisler,

This letter serves two purposes. First, it expresses Public Citizen's concern regarding the license to supply electricity the PSC granted to Reliant Energy Solutions East, LLC (Reliant East) on May 21, 2003. Less than a year after approving the license, an affiliate of the company, Reliant Energy Services, Inc. (Reliant Services) was indicted for alleged manipulation of electricity markets.[1] Public Citizen believes the criminal indictment of an affiliate on which the licensee relies to supply Maryland consumers with power represents a significant material change that should prompt a PSC review of whether to revoke Reliant East's license to supply electricity.

In addition, data compiled by Public Citizen indicates that Reliant East filed a false license application with the Maryland PSC by failing to disclose a $25 million penalty levied against its affiliate for refusing to provide electricity when ordered to do so by a state Independent System Operator (ISO), raising questions about the integrity of Reliant East to be a licensed supplier.

Second, Public Citizen is concerned that the PSC's current license review and approval process is inadequate to protect consumers, especially since government officials rely on PSC's license approvals for guidance. In a letter Public Citizen received from Baltimore officials defending their decision to award a $67.3 million contract to Reliant East despite the indictment of its affiliate, they wrote that Reliant East "is licensed by the Public Service Commission to sell electricity in the State of Maryland. We therefore have no basis to deviate from our responsibility concerning the award of the contract…"[2]

This deference to the PSC to determine which energy suppliers are "responsible" under state law[3] would be more comforting if the PSC licensing process was strengthened by asking more specific questions. Public Citizen recommends three PSC reforms that would result in a more effective licensing process.

Enclosed is documentation that Reliant East filed a false application to the PSC on March 6, 2003.[4] Question 8 of the application, "Reliability and Environmental Official Actions Against Applicants/ Affiliates," asks the applicant whether there are "Official Actions that have been taken against the

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[1] www.usdoj.gov/usao/can/press/assets/applets/2004_04_08_Reliant_.pdf
[2] www.citizen.org/documents/BaltLtr.pdf
[3] State Finance and Procurement, § 13-206, http://mlis.state.md.us/cgi-win/web_statutes.exe?gsf&13-206
[4] Maillog # 87124

Applicant *and any Affiliate* (if available to the Applicant) that engages in the sale at retail of electricity, *or electric generation supply services*, or natural gas for matters relating to environmental *or reliability status* for the past two years." [emphasis added]

Reliant East answered "No" to this question, even though its electric generation supply affiliate, Reliant Services, was fined $25 million by the California Independent System Operator for reliability-related offenses.

According to the California Independent System Operator's July 3, 2002 *Market Notice*,[5] Reliant Services was ordered to pay a penalty of $25,057,729.42 "for failure to comply with dispatch instructions during system emergencies." In Public Citizen's view, this large fine against Reliant Services for violation of power dispatch instructions ordered during a system emergency is grounds for immediate investigation by the Maryland PSC into whether or not affiliate Reliant East's license should be revoked.

This penalty eventually led to the federal criminal charges against the affiliate. On April 8, 2004, a federal grand jury returned a 6-count indictment against Reliant Services, alleging that the company helped cause the West Coast energy crisis of 2000-01. The company is accused of intentionally shutting down four of its power plants, creating power blackouts leading to price increases that allowed the company to reap higher profits. These allegations are particularly important given that Reliant Energy owns 21 power plants in the Maryland area, whose electricity is marketed by Reliant Services and sold to Reliant East.

Prior to the multi-count indictment, the parent company, Reliant Energy, volunteered to pay $83 million in fines, penalties, and refunds to settle allegations that the company manipulated markets. In January 2003, Reliant Energy agreed to pay $13.8 million to the Federal Energy Regulatory Commission (FERC) to settle allegations that the company's trading subsidiary, Reliant Services, intentionally withheld power from California to reap higher profits.[6] In October 2003, Reliant Energy again agreed to pay as much as $50 million to FERC to settle allegations the company's subsidiary manipulated the California energy market.[7] One month later, Reliant Energy agreed to pay $18 million to the U.S. Commodity Futures Trading Commission to settle charges that the company's subsidiary engaged in manipulation of energy markets.[8] In March 2004, Reliant Energy agreed to pay $836,000 to FERC to settle additional allegations that the company manipulated energy markets.[9]

It is unclear as to whether or not Reliant East informed the PSC of these charges against its affiliate, since the company's annual license update, filed with the PSC on April 30, 2004, does not appear to include a revised Schedule 7.[10]

What is clear, however, is that Reliant East depends on its indicted affiliate to supply Maryland consumers—including state and local government entities—with power. Reliant East wrote in its *Application for Supplier License* filed with the PSC that it "intends to enter into a *full requirements*

[5] www.caiso.com
[6] www.ferc.gov/press-room/pr-archives/2003/2003-1/01-31-03-reliant.pdf
[7] www.ferc.gov/press-room/pr-archives/2003/2003-4/10-02-03.asp
[8] www.cftc.gov/files/enf/03orders/enfreliantenergy_order.pdf
[9] www.ferc.gov/whats-new/comm-meet/030304/E-38.pdf
[10] A search of Maillog # 92562 in the PSC's docket room provides a reference to an "attached" revision to Schedule 7, but no such attachment could be found.

bilateral agreement with Reliant Energy Services, Inc., an affiliate and current member of PJM"[11] [emphasis added]. This statement indicates that Reliant Services supplies *all* of Reliant East's power needs.

Public Citizen's review of documents that Reliant Energy filed with federal regulators shows that Reliant East has an interdependent relationship with the indicted subsidiary, Reliant Services. The indicted subsidiary conducts most of its operations in the Maryland region and sells electricity to Reliant East. In addition, not only are both Reliant Services and Reliant East 100% owned by the same parent company, but at least three top officers hold positions with both Reliant Services and Reliant East.

According to the first quarter 2004 *Electric Quarterly Report*[12] that Reliant Energy Mid-Atlantic Power Holdings, LLC ("Reliant Mid-Atlantic" is a subsidiary of Reliant Energy, Inc.) filed with the Federal Energy Regulatory Commission (FERC), 100% of its electricity sales were to Reliant Services, which then marketed the power to retail clients. Reliant Mid-Atlantic owns about 10 power plants in the greater Maryland area.

First quarter 2004 *Electric Quarterly Reports* filed by Reliant Energy Maryland Holdings, LLC (a subsidiary of Reliant Mid-Atlantic) show that 100% of its electricity sales were also to Reliant Services.

Reliant Energy Hunterstown, LLC, another subsidiary of Reliant Energy, Inc., owns an 866 MW gas-fired power plant located on the Pennsylvania-Maryland border. It also recorded electricity transactions only with Reliant Services in its first quarter 2004 *Electric Quarterly Report*.

Another Reliant Energy, Inc. subsidiary, Reliant Energy Seward, LLC, owns a 585 MW coal-fired power plant east of Pittsburgh. Again, Seward's first quarter 2004 *Electric Quarterly Report* only recorded electricity sales to Reliant Services.

As a result of these interdependent relationships, Public Citizen believes that the PSC should review the license it awarded to Reliant East.

The U.S. Congress shares Public Citizen's concerns. On July 14, 2004, the House-Senate appropriations conference committee added language to H.R. 4613 ordering the Department of Defense to review the contract that federal agency awarded to Reliant East.[13] Congress took this action in response to questions Public Citizen raised about the propriety of Reliant East continuing the terms of the contract in light of its affiliate's indictment.

The second component of this letter provides recommendations on how the PSC can enhance license application disclosure to better protect the public.

First, Public Citizen recommends requiring all applicants to provide information on any interlocking positions jointly held by officers with the licensee and the licensee's affiliates (including their common parent), as such information is crucial to understanding the inter-relatedness of affiliates. In this case, the *Application for Authority to Hold Interlocking Positions* Reliant Energy, Inc. filed with FERC on

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[11] Maillog # 87124, Schedule 9.
[12] These reports are available online at www.ferc.gov/docs-filing/eqr/data/spreadsheet.asp
[13] Conference Report, page 372, http://thomas.loc.gov/

May 27, 2004, lists three officers as holding positions with both Reliant Services and Reliant East: Daniel Hannon as Senior Vice-President of both Reliant Services and Reliant East; Tanya Rohauer as Assistant Treasurer for both; and Wendi Zerwas as Assistant Corporate Secretary for both.[14] This information—that three top officers share positions at both the indicted and licensed entities—was not volunteered by Reliant East and provides crucial information not currently solicited by the PSC.

Second, the PSC should require the applicant to provide copies of the actions disclosed in Question 7 ("Actions Against Licenses"). For example, in the March 2003 license application filed by Reliant East, the company summarized its $13.8 million settlement with FERC in the most benign way possible, claiming the payment was made "related to trading practices in California." When one reads FERC's announcement of the settlement, however, it is clear that Reliant chose to leave out important details: "Reliant's traders intentionally reduced the quantity of megawatts offered…Reliant elected to perform discretionary maintenance on generating units whose output otherwise normally would have been offered… Statements made by some of Reliant's traders indicate that the reason for reducing bids was an attempt to increase prices…Reliant must also retain an independent engineering company for 24 months to determine that any outages at its California generating plants are legitimate, with the audits sent directly to the Commission."[15]

Our final recommendation would be to require a licensee to disclose *Electric Quarterly Reports* that it and any of its affiliates file with FERC, providing key detail as to how the licensee plans to fulfill obligations to sell power in Maryland.

Public Citizen respectfully requests a prompt response to this letter.

Sincerely,

Tyson Slocum
Research Director, Energy Program

Cc:

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Eric Osborn, Reliant Energy Solutions East, LLC

[14] http://elibrary.ferc.gov/

[15] Docket PA02-2-001, http://elibrary.ferc.gov/