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August 19, 2004

**VIA HAND DELIVERY**

Ms. Felicia Greer  
Executive Director  
Maryland Public Service Commission  
William Donald Schaefer Tower  
6 St. Paul Street  
Baltimore, MD 21202-6806

**Re: Reliant Energy Solutions East, LLC's Electricity Supplier License – IR-525**

Dear Ms. Greer:

On August 10, 2004, I received a letter from your office directing Reliant Energy Solutions East, LLC ("RESE") to respond to the allegations in a letter filed with the Public Service Commission ("Commission") on July 29, 2004 by Public Citizen. Your letter specifically directs RESE to file its response with the Commission on or before August 19, 2004, and to serve a copy of the response on Public Citizen. Accordingly, this letter constitutes Reliant's response to the allegations in Public Citizen's letter to the Commission. As noted below, a copy of this response is being served on Public Citizen today via U.S. mail.

Public Citizen's letter includes two allegations that it claims form sufficient justification for the Commission to review whether RESE's electricity supplier license should be revoked. First, Public Citizen claims that the indictment of an affiliate of RESE, Reliant Energy Services, Inc. ("RES"), coupled with RESE's reliance on that affiliate as a source of power supply in Maryland, represents a significant material change that should prompt a Commission review of the RESE license. Second, Public Citizen alleges that RESE filed a "false license application" with the Commission by failing to disclose certain charges incurred pursuant to the California Independent System Operator's tariff.

**Reliant Energy Services, Inc. Indictment**

RESE filed its electricity supplier license application with the Commission on March 6, 2003. The application was approved, and the license was granted, on May 21, 2003. In its application, Reliant disclosed the FERC investigation into the events that led to the indictment discussed below and the resulting settlement agreement with FERC. Since its initial filing, RESE has filed supplemental information with the Commission on an ongoing basis in compliance with the Commission's requirement that electricity suppliers provide notice of material changes to previously filed information.

On April 30, 2004, RESE filed supplemental information with the Commission providing details of an indictment against RES. As noted in that filing, the United States Attorney's office in the Northern District of California indicted RES, a subsidiary of Reliant Energy, Inc. (herein "Reliant" and formerly known as Reliant Resources, Inc.) and an affiliate of RESE. In addition, the United States Attorney indicted four former and current employees of RES, none of whom is an officer of RESE, RES, or Reliant. The indictments are based on allegations that RES engaged in price manipulation by curtailing electricity generation in California on two days in June 2000 at the direction of its traders. The applicant, RESE, was formed on February 4, 2002, and no officer of RESE was an officer of RES or Reliant in any capacity during the period covered by the indictment.

In January 2003, Reliant entered into a settlement agreement with the FERC regarding the actions that are the subject of the indictment. In the settlement, Reliant neither admitted nor denied that these actions affected prices in any market, or violated any law, tariff or regulation. Reliant discovered this behavior as part of its review of past trading practices in California and voluntarily brought it to the attention of the FERC. Although Reliant believes that the traders' actions were not in violation of any laws, tariffs or regulations, they were not consistent with how Reliant operates or the expected behavior of its employees. Reliant agreed to the settlement with FERC in order to, among other things, put these issues behind it and move forward with its business. The company took appropriate personnel actions with respect to the employees involved, as well as substantive and definitive steps, including implementing wide-ranging changes in the senior management team (including replacing all but the secretary and assistant treasurer of RES, retaining only one member of the board of directors from that period, and establishing new lines of authority and accountability), instituting a code of conduct for its trading employees to define the parameters of acceptable and unacceptable trading behavior, and strengthening its corporate compliance program (including the establishment of the Chief Compliance Officer and two other compliance positions). These corrective actions evidence Reliant's commitment to conducting its business with the highest integrity.

It is important to keep in mind that the actions that are the subject of the indictments relate to an isolated situation involving trading activity over a two-day period more than four years ago. There was no supply shortage at the time, no ISO-declared emergency, no blackouts, and the two days fell during a low-priced week in the market. Reliant's total generation during the period far outpaced historical generation levels. Reliant intends to defend vigorously the charges in the indictments. Furthermore, RESE does not believe that the indictments will have any material adverse impact on its ongoing business operations, including its ability to provide reliable electric service under its contracts with Maryland consumers.

## **Electricity Supplier Application**

As noted above, RESE filed its electricity supplier license application on March 6, 2003. In its application, RESE included a detailed response regarding actions against RESE and its affiliates engaged in the sale at retail and wholesale of electricity or natural gas, including suspensions, revocations, limitations, reprimands and fines. Public Citizen, however, alleges that RESE filed a false application by failing to disclose information in response to Question 8 of the application, "Reliability and Environmental Official Actions Against Applicants/Affiliates," which requires disclosure of "Official Actions that have been taken against the 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." Public Citizen specifically alleges that RESE was required to disclose a "\$25 million penalty" assessed on RESE's affiliate by the California Independent System Operator ("CAISO") pursuant to CAISO Tariff Section 5.6.3. This section of the CAISO tariff, which was cancelled by the FERC effective June 20, 2001, permitted the CAISO to assess penalties against scheduling coordinators during a declared system emergency. Although Public Citizen describes these charges as a single penalty, in fact, they were an accumulation of tariff-based charges for imbalances over a period of seven months and more than 25,000 individual dispatch intervals.

RESE believes the CAISO charges are not "Official Actions" relating to "environmental or reliability status" within the meaning of the question. These charges were commercial penalties that, unlike regulatory penalties, were not the subject of any regulatory body's investigation, deliberation, or a finding of wrongdoing on the part of RES or any other market participant assessed penalties pursuant to CAISO Tariff Section 5.6.3. They were part of the routine settlement process which was used to calculate net amounts owed for each 10 minute dispatch interval. These charges simply provided financial incentives to improve dispatch performance during emergency conditions. by allowing the CAISO to deduct from monthly remittances an amount equal to two times the highest price paid by the CAISO for power in each interval when an individual generator's metered output fell short of day ahead and hour ahead schedules combined with CAISO's dispatch instructions. However, there often were operational reasons that a generator might be unable to comply with instructions. For example, the CAISO dispatch instructions, despite best efforts by Reliant dispatching and operating personnel, were often physically impossible to meet due to ramping limitations and unexpected generation contingencies. There were no docket numbers, offense dates, case numbers, or similar administrative proceedings to reference or disclose.

RESE's application complied with the Commission's requirements because RESE's answer to Item 8 on the license application was then and is now correct. RESE carefully and thoroughly completed the application and required disclosure including, out of an abundance of caution, disclosure of various FERC proceedings against RESE's affiliates not engaged in the sale of electricity at retail and, in one case, a former affiliate of RESE that had been engaged in the sale of gas at retail. RESE's answers also referenced the more extensive disclosures provided in filings with the Securities and Exchange Commission, which filings were provided to facilitate

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review by the Commission. All of this information was made available in response to Item 7 of the Application. Further, RESE has conscientiously updated its filing in a timely manner with the Commission, including a supplemental filing regarding an indictment of a non-retail affiliate. RESE's conduct evidences an intent to provide the Commission with full information to evaluate its application and is not consistent with an intent to conceal information that should have been disclosed.

Sincerely,

Ike Gibbs

cc: Mr. Tyson Slocum, Public Citizen (via U.S mail)