

140 FERC ¶ 61,032
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony T. Clark.

Competitive Energy Services, LLC

Docket No. IN12-12-000

ORDER TO SHOW CAUSE AND NOTICE OF PROPOSED PENALTY

(Issued July 17, 2012)

1. Pursuant to Rule 209(a)(2) of the Commission's Rules of Practice and Procedure,¹ the Commission's Revised Policy Statement on Enforcement,² and the Commission's Statement of Administrative Policy Regarding the Process for Assessing Civil Penalties,³ the Commission directs the above-captioned company to show cause why it should not be found to have violated section 1c.2 of the Commission's regulations and section 222 of the Federal Power Act (FPA).⁴ Competitive Energy Services, LLC (CES or Respondent) is alleged to have violated section 1c.2 by engaging in fraud in ISO New England, Inc.'s (ISO-NE) Day-Ahead Load Response Program (DALRP). The Commission further directs Respondent to show cause why it should not be assessed a civil penalty in the amount of \$7,500,000, or a modification of that amount consistent with section 31(d)(4) of the FPA, and disgorge \$166,841.13 of payments received as a result of participation in the DALRP (plus interest).⁵ Pursuant to Rule 213(a) of the Commission's Rules of Practice and Procedure,⁶ the Commission directs Respondent to file an answer with the

¹ 18 C.F.R. § 385.209(a)(2) (2011).

² *Enforcement of Statutes, Regulations and Orders*, 123 FERC ¶ 61,156, at P 35-36 (2008).

³ *Process for Assessing Civil Penalties*, 117 FERC ¶ 61,317, at P 5 (2006).

⁴ 18 C.F.R. § 1c.2; 16 U.S.C. § 824v(a).

⁵ We note that under section 31(d)(4) of the FPA, 16 U.S.C. 823b(d)(4), the Commission may "compromise, modify, or remit, with or without conditions, any civil penalty which may be imposed . . . at any time prior to a final decision by the court of appeals . . . or by the district court."

⁶ 18 C.F.R. § 385.213(a).

Commission within 30 days of the date of this order. Office of Enforcement Staff (OE staff) may reply to Respondent's answer within 30 days of the filing of the answer.

2. This case presents allegations by OE staff of violation of the Commission's Prohibition of Energy Market Manipulation. These allegations arose out of an investigation conducted by OE staff and are described in the Enforcement Staff Report and Recommendation submitted to the Commission on April 17, 2012 (OE Staff Report).⁷ The OE Staff Report alleges that employees of CES conceived of a fraudulent scheme in connection with the DALRP participation of Rumford Paper Company (Rumford), a lumber mill in Rumford, Maine. Specifically, OE staff alleges that CES advised Rumford to adopt, and, along with Rumford, implemented, a plan to inflate Rumford's load baseline and then repeatedly offer load reductions at the minimum offer price in order to freeze the inflated baseline, maximizing payments for phantom load reductions. The OE Staff Report alleges that, at CES's urging, Rumford curtailed generation during the baseline period, intentionally creating a misleading baseline. Further, OE staff alleges that CES offered load response by Rumford on a daily basis, fraudulently communicating a willingness and ability to reduce load. The OE Staff Report alleges that CES understood that Rumford would not reduce load and, in fact, did not reduce load, contrary to its DALRP load reduction offers.

3. Based on the allegations contained in the OE Staff Report, the Commission orders Respondent to respond to this order as set forth above.⁸ This order also is the notice of proposed penalty required pursuant to section 31 of the FPA.⁹ In the answer to this order, Respondent has the option to choose between either (a) an administrative hearing before an ALJ at the Commission prior to the assessment of a penalty under section 31(d)(2), or (b) an immediate penalty assessment by the Commission under section 31(d)(3)(A). If Respondent elects an administrative hearing before an ALJ, the Commission will issue a hearing order; if Respondent elects an immediate penalty

⁷ The OE Staff Report is attached to this order as Appendix A. The OE Staff Report describes the background of OE staff's investigation, findings and analysis, and proposed sanctions.

⁸ Under 18 C.F.R. § 385.213(c) (2011), Respondent must file an answer that provides a clear and concise statement regarding any disputed factual issues and any law upon which it relies. Respondent must also, to the extent practicable, admit or deny, specifically and in detail, each material allegation contained in the OE Staff Report and set forth every defense relied upon. Failure to answer an order to show cause will be treated as a general denial and may be a basis for summary disposition under Rule 217. 18 C.F.R. § 385.213(e)(2).

⁹ 16 U.S.C. § 823b(d) (2006).

assessment, and if the Commission finds a violation, the Commission will issue an order assessing a penalty. If such penalty is not paid within 60 days of assessment, the Commission will commence an action in a United States district court for an order affirming the penalty, in which the district court may review the assessment of the civil penalty *de novo*.¹⁰

4. The Commission authorizes OE staff to disclose information obtained during the course of the investigation as necessary to advance this matter.

The Commission orders:

(A) Within 30 days of the date of this order, Respondent must file an answer in accordance with Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, showing cause why it should not be found to have violated 18 C.F.R. § 1c.2 and 16 U.S.C. § 824v(a) with respect to CES's participation in ISO-NE's DALRP.

(B) Within 30 days of the date of this order, Respondent must file an answer in accordance with Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, showing cause why its alleged violation should not warrant the assessment of civil penalties in the amount of \$7,500,000, or a modification of that amount consistent with section 31(d)(4) of the FPA, and require it to disgorge \$166,841.13 of payments received as a result of participation in ISO-NE's DALRP.

(C) In any answer, Respondent should address any matter, legal, factual or procedural, that it would urge in the Commission's consideration of this matter.

(D) Within 30 days of the date of this order, Respondent may also elect (a) an administrative hearing before an ALJ at the Commission or (b) if the Commission finds a violation, an immediate penalty assessment by the Commission which a United States district court is authorized to review *de novo*.

¹⁰ FPA Section 31(d)(3)(B), 16 U.S.C. § 823b(d)(3)(B)(2006). *See also Process for Assessing Civil Penalties, supra* note 3.

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(E) Within 30 days of the filing of the answer by Respondent, Enforcement staff may file a reply with the Commission.

By the Commission. Commissioner LaFleur concurring with a separate statement attached.

(S E A L)

Kimberly D. Bose,
Secretary.

APPENDIX A

Enforcement Staff Report re: Competitive Energy Services, LLC



FEDERAL ENERGY REGULATORY COMMISSION

Competitive Energy Services, LLC

Enforcement Staff Report and Recommendation

Office of Enforcement
Division of Investigations

July 17, 2012

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The Office of Enforcement (Enforcement or staff) reports to the Federal Energy Regulatory Commission (Commission) its findings regarding the conduct of Competitive Energy Services, LLC (CES) in connection with CES's participation in ISO New England, Inc.'s (ISO-NE) Day-Ahead Load Response Program (DALRP).¹

I. EXECUTIVE SUMMARY

Enforcement recommends that the Commission issue an Order to Show Cause and Notice of Proposed Penalty to CES requiring it to show cause why it did not violate 18 C.F.R. § 1c.2 in connection with its participation in ISO-NE's DALRP, should not pay a civil penalty in the amount of \$7,500,000, and should not disgorge \$166,841.13 in unjust profits (all payments received as a result of participation in ISO-NE's DALRP).

CES employees conceived a scheme to defraud ISO-NE of demand response payments, advised a DALRP participant, Rumford Paper Company (Rumford), to adopt the scheme, and helped implement the scheme. Specifically, Richard H. Silkman, Ph.D. (Silkman), the Managing Member of CES, working with other CES employees, advised Rumford to curtail internal generation by approximately 30-40 MW during the five-day period when Rumford's initial baseline load was established for the DALRP. Instead of operating the generator to supply Rumford with virtually all of its energy needs (as was typical for the facility), CES and Rumford decided to curtail the generator and purchase replacement energy during the baseline period at a \$120,000 cost. By purchasing energy, instead of producing it on site, CES and Rumford reported larger energy consumption to ISO-NE than otherwise would have been the case, thereby establishing a false and inflated baseline.

Once in the DALRP, the artificially inflated baseline allowed Rumford to claim load reductions (the difference between the baseline and Rumford's typical operations) without actually reducing any load. CES perpetuated and profited from this misrepresentation for over six months in 2007 to 2008, engaging in a scheme that ensured the baseline never appreciably changed. Because of CES's behavior, electricity consumers in New England paid \$3,336,964.63 for demand response that never occurred.

¹ Citations in this Report are to documents and sworn testimony in Enforcement's nonpublic investigation. Citations to most documents refer to the entity supplying each document and the electronic or physical bates stamp (*e.g.*, CES000029) and transcript references refer to the last name of the deponent, page, and line of the relevant transcript (*e.g.*, Silkman Dep. 30:5-10). All cited documents and transcripts are available for Commission review.

Of this amount, CES obtained \$166,841.13 in revenue from July 2007 through January 2008.²

Staff's investigation of CES and other ISO-NE demand response participants included nine depositions and multiple sets of data requests and responses. CES was informed both orally and in writing of staff's views, and was invited to apprise staff of any errors, any alternate views, or defenses. Staff fully considered CES's submissions.

Staff engaged CES in settlement negotiations, but was unable to reach an agreement. On May 13, 2011, staff provided CES written notice, pursuant to 18 C.F.R. § 1b.19 (2011), of staff's intent to recommend that the Commission issue an Order to Show Cause. CES responded on June 27, 2011; that response is being provided to the Commission with this Report. CES argues, among other things, that CES did not violate § 1c.2 of the Commission's regulations, that CES is not subject to the Commission's jurisdiction under § 1c.2, and that a civil penalty within the ranges established by the Commission's Penalty Guidelines³ would bankrupt CES.⁴

II. BACKGROUND

A. CES and Rumford

CES is an independent energy services company based in Portland, Maine. Beginning in 2003, CES provided consulting services regarding several energy-related initiatives to Rumford, which owns and operates a large lumber mill in Rumford, Maine and produces a wide variety of paper products.⁵ As a result, in 2007, CES was very familiar with Rumford's physical plant and energy use. During the time frame covered by Enforcement's investigation, when the mill was fully operational its electricity consumption was generally in the 95 MW range. The mill operated 24 hours a day in equal work shifts and its load did not fluctuate appreciably between day and night hours.

² See Constellation0023813. CES received these revenues during Rumford's July 31, 2007 through February 6, 2008 DALRP participation.

³ See *Revised Policy Statement on Penalty Guidelines*, 132 FERC ¶ 61,216 (2010) (Penalty Guidelines).

⁴ June 27, 2011 Response of CES to § 1b.19 Notice, *passim* (CES's 1b.19 Response). While CES responded jointly with another subject of staff's investigation, Silkman, staff has evaluated violations by CES and Silkman separately.

⁵ Rumford is a subsidiary of NewPage Corporation (NewPage), an international paper manufacturer. On September 7, 2011, Rumford and NewPage filed for voluntary reorganization under Title 11 of the United States Code.

As CES understood, the Rumford facility generally operated its on-site 110 MW generator (referred to as “G4”) to meet all of its electricity needs, purchasing additional or selling excess energy as necessary. G4’s operation also produced steam which Rumford used as part of its manufacturing process.

CES occasionally solicited load response customers in New England for Constellation NewEnergy, Inc. (Constellation) under a Master Broker Agreement between CES and Constellation.⁶ Pursuant to this agreement, CES referred customers to Constellation, and Constellation acted as the customer’s Enrolling Participant in ISO-NE. Constellation compensated CES for the referral based upon a percentage the customer’s load response revenues. Through this arrangement CES received 5% of the amount associated with Rumford’s DALRP participation.

Dr. Richard Silkman is the most senior manager at CES and has provided expert economic testimony on a variety of matters in proceedings before the Commission and elsewhere. Although Silkman claims he does not hold himself out as an expert on demand response issues,⁷ he and CES regularly provide demand response consulting services and, in spring 2007, Silkman approached Rumford to suggest that it participate in ISO-NE’s load response programs.

B. The DALRP

Demand response is a “change[] in electric usage by end-use customers from their normal consumption patterns in response to changes in the price of electricity over time, or to incentive payments designed to induce lower electricity use at times of high wholesale market prices or when system reliability is jeopardized.”⁸ Demand response

⁶ Master Broker Agreement between Constellation NewEnergy, Inc. and Competitive Energy Services, LLC (signed by Richard Silkman, August 28, 2006).

⁷ Silkman Dep. at 18:9-13.

⁸ *U.S. Department of Energy, Benefits of Demand Response in Electricity Markets and Recommendations for Achieving Them: A Report to the United States Congress Pursuant to Section 1252 of the Energy Policy Act of 2005*, February 2006. This meaning of demand response was also adopted in the Commission staff’s report, *Assessment of Demand Response and Advanced Metering*, Docket No. AD06-2-000, at 5 (available at <http://www.ferc.gov/legal/staff-reports/demand-response.pdf>) in August 2006. This definition is consistent with the definition recently incorporated in the Commission’s regulations: “a reduction in the consumption of electric energy by customers from their expected consumption in response to an increase in the price of electric energy or to incentive payments designed to induce lower consumption of electric energy.” 18 C.F.R. § 35.28(b)(4)(2011). Further, the Commission has stated that, in

requires, at the least, either reduced consumption or increased production of electricity by the responder.⁹ Demand response programs in Commission-jurisdictional markets improve competition in those markets and help fulfill the Commission's mandate under the Federal Power Act (FPA) that rates for energy are just, reasonable, and not unduly discriminatory or preferential.¹⁰

ISO-NE's DALRP was implemented in June 2005 as a supplemental program to ISO-NE's real-time load response programs.¹¹ The goal of all of ISO-NE's load response programs is to "reduc[e] peak electricity demand by large power users."¹² The DALRP reduces energy prices in ISO-NE by compensating resources that offer load reductions, and then actually reduce load, for hours in the next day when New England experiences high energy prices. The DALRP requires that enrolled resources "provide a reduction in

wholesale markets like ISO-NE, "demand response, whereby customers reduce consumption from normal usage levels in response to price signals, can generally occur [when] customers provide demand response that acts as a resource in organized wholesale energy markets to balance supply and demand." *Demand Response Compensation in Organized Wholesale Energy Markets*, 134 FERC ¶ 61,187 at P 9 (2011) (Order No. 745), *order on reh'g*, 137 FERC ¶ 61,215 (2011) (Order No. 745-A).

⁹ Silkman and CES understood during the period covered by Enforcement's investigation that demand response requires a change in a participant's consumption pattern. For example, Silkman represented CES as a stakeholder participant of the New England Demand Response Initiative, which stated that "Demand Response Resources (DR resources) include all intentional modifications to the electric consumption patterns of end-use customers that are intended to modify the quantity of customer demand on the power system in total or at specific time periods." See *Dimensions of Demand Response: Capturing Customer Based Resources in New England's Power Markets, Report and Recommendations of the New England Demand Response Initiative*, at 6 (July 23, 2003) (available at <http://nedri.raabassociates.org/index.asp>).

¹⁰ Order No. 745 at P 8-9 (citing 16 U.S.C. § 824d (2006)).

¹¹ *New England Power Pool and ISO New England, Inc.*, 111 FERC ¶ 61,064 (2005). The Commission has since approved periodic changes to the demand response provisions in ISO-NE's tariff. Note that all references to ISO-NE's tariff and manuals are to the versions of these documents in effect during the time covered by Enforcement's investigation, unless otherwise noted. Capitalized terms in this Report have the same meaning as provided in ISO-NE's FERC-approved tariff or relevant manuals as they existed during the time covered by Enforcement's investigation.

¹² ISO New England Load Response Program Manual at 1-1 (LRP Manual).

their electricity consumption in the New England Control Area during peak demand periods.”¹³

During the period covered by Enforcement’s investigation, a load response resource began participation through the establishment of an initial customer load baseline, which was intended to reflect the quantity of energy the resource would have used absent participation in the DALRP. The initial load baseline was calculated by a simple average of hourly meter data from 7:00 AM through 6:00 PM for energy taken from the grid for the initial five business days after the asset was approved for the DALRP.¹⁴ Once an initial baseline was established, the baseline adjusted on a rolling basis using actual load data from the resource.¹⁵

However, not all days were included in the rolling baseline calculation. Most important, when a customer’s daily DALRP offer was accepted for a given day, that day would be excluded from the rolling customer baseline.¹⁶ The reason for this exclusion is that the baseline was intended to represent an asset’s typical operating condition absent participation in the DALRP, and loads during demand response days are not typical as demand response resources are reducing energy usage on these days.

Unlike some other demand response programs, the DALRP was not a program in which ISO-NE contacted participants to request load reductions. Instead, DALRP participants offered load reductions for the next day from the hours of 7:00 AM through 6:00 PM on non-holiday weekdays and, if ISO-NE accepted the offer, the participant was obligated to reduce load the next day. Resources were allowed to offer load reductions by specifying a minimum price (in \$/MWh) and a fixed amount (in MW/h) of load reduction.¹⁷ The participant’s real-time load was measured against its baseline to quantify the load reduction.¹⁸ As an example, if in a given hour a resource’s baseline was 90 MW and actual electrical consumption from the grid was 87 MW, the calculated load reduction would be 3 MW.

¹³ ISO-NE Tariff, Appendix E to Market Rule 1, § III.E.1.1.

¹⁴ LRP Manual § 4.2.1.

¹⁵ *Id.*

¹⁶ *Id.*, § 4.2.2.

¹⁷ *Id.*, § 4.5.1.1.

¹⁸ *Id.*, § 4.3.1.3.

During the period covered by Enforcement's investigation, the minimum DALRP offer price was \$50.00 per MWh.¹⁹ Resources with offers that cleared the market were paid the Locational Marginal Price (LMP) in the Day-Ahead Energy Market for the amount of load reduction that cleared.²⁰ If resources reduced more in Real-Time than the amount cleared in the DALRP as measured against their customer baseline, they were paid for the excess at the LMP in the Real-Time Energy Market. If they reduced less in Real-Time relative to a cleared offer, they were required to buy back the difference at the Real-Time LMP.²¹

Demand response resources participated in the DALRP with assistance from third-parties known as Enrolling Participants.²² The Enrolling Participant registered the resource in the DALRP program and arranged for ISO-NE to receive load response and meter data from the resource. ISO-NE made DALRP payments to the Enrolling Participant, and the Enrolling Participant then distributed these revenues to the load response resource and any other entities based upon agreements among those parties.²³ Regarding Rumford's participation, Constellation retained 10% of DALRP revenues as the Enrolling Participant and distributed 85% to Rumford and 5% to CES as Constellation's broker.²⁴

III. STAFF'S FINDINGS AND ANALYSIS

A. Findings

CES Devised a Scheme for Rumford's DALRP Participation

In mid-2007, CES approached Ronald Guay, Senior Counsel of NewPage Corporation (Rumford's parent company), regarding Rumford's possible load response

¹⁹ Effective February 7, 2008, the Commission approved modifications to ISO-NE's tariff to tie the DALRP minimum offer price to an indexed amount that reflects fuel prices. *See ISO New England, Inc.*, 123 FERC ¶ 61,021, *reh'g denied*, 124 FERC ¶ 61,235 (2008). Rumford ceased offering load response into the DALRP after the rule change, though it remained enrolled in the DALRP program.

²⁰ LRP Manual § 4.5.1.1.

²¹ *Id.*, § 4.5.1.1.

²² *Id.*, § 2.2.1.

²³ *Id.*, § 4.5.4.

²⁴ CES Response to Data Request 7(b).

participation.²⁵ CES claimed it believed that Rumford would be a good candidate for load response because the mill was a large industrial consumer of energy and had the ability to modify its on-site generation and electricity usage.²⁶

Silkman of CES developed a scheme for Rumford's DALRP participation premised on Rumford's curtailment of generation from G4.²⁷ Silkman informed Rumford that it could curtail generation during the initial, five-day baseline creation period and then make daily load reduction offers at the minimum offer price.²⁸ Curtailing generation from G4 would require Rumford to temporarily increase its purchase of electricity. But, more important, curtailment would communicate to ISO-NE a higher demand for electricity which would result in an inflated initial baseline.

CES's Silkman proposed that, once it began participating in the DALRP, Rumford would operate G4 as it typically had operated. In effect, this meant Rumford would *appear* to be reducing load relative to its inflated baseline without actually doing so. As Silkman explained to Rumford managers, if Rumford's DALRP offers cleared each day, the baseline would stay static and would not change to reflect actual generation or the mill's energy usage.²⁹ Since the baseline would stay static, Rumford could be regularly compensated for its claimed load reduction. In fact, Silkman told Rumford managers that Rumford's offers would clear every day.³⁰ Once the baseline was set, Rumford needed only to comply with the ministerial and administrative aspects of the program while operating as usual,³¹ i.e., there would be no actual reduction of load.

In June and July 2007, Silkman, other CES personnel, and groups of senior Rumford personnel met multiple times to discuss Rumford's participation in the DALRP

²⁵ Guay Dep. 45-46.

²⁶ Silkman Dep. 106-108.

²⁷ *Id.* at 203:11-14.

²⁸ *See, e.g.*, Alley Dep. 143:13-16.

²⁹ *Id.* at 90-91 and 119-120.

³⁰ *Id.* at 119:18-20.

³¹ Alley testified that Rumford expected "none, to very limited" changes in its operations due to DALRP participation under the scheme outlined by Silkman. *Id.* 139:7-9. Alley also stated that, to the best of his recollection, Rumford never had to reduce its electrical consumption in order to meet its DALRP load reduction commitments. *Id.* 140:19-24 and 141.

based on CES's scheme.³² Silkman proposed that CES would, at Rumford's direction, manage day-to-day activities associated with submitting DALRP offers with Constellation acting as the Enrolling Participant for Rumford.³³

At these meetings, Silkman explained to Rumford how the DALRP worked, how Rumford could participate, Rumford's obligations under the program, and money-making opportunities in the DALRP.³⁴ Rumford commissioned CES to prepare a "White Paper" describing potential load response participation.³⁵ In this paper, CES stated that it had been tracking "zero baseline facilities," (i.e., facilities that were neither net importers nor exporters of energy, like Rumford) and concluded that such facilities could participate and receive full compensation.³⁶

While considering CES's proposal, Rumford evaluated the cost of purchasing replacement energy during the baseline period to make up for the planned curtailment of G4.³⁷ Silkman predicted and Rumford anticipated an increased out-of-pocket cost of \$120,000 to purchase additional energy from the grid.³⁸ Silkman advised that Rumford could expect to recoup this expense within a week of DALRP participation.³⁹ Silkman did not identify any cost or risk associated with Rumford's participation other than the initial cost of increased energy purchases.

³² CES Response to Data Request 2 (describing meetings on June 12 and July 6).

³³ CES Response to Data Requests 7(a) and 7(d).

³⁴ Silkman Dep. 166:1-13.

³⁵ *Id.* at 179:4-13. Rumford paid \$7,500 for the White Paper, which was produced during Enforcement's investigation. *See* RUMF000001-000003.

³⁶ Rumf000001. In response to Enforcement data requests, CES produced no written materials demonstrating research it conducted into "zero baseline facilities" to support this statement.

³⁷ Alley Dep. 126:2-6.

³⁸ E-mail from Richard Silkman, Managing Member, Competitive Energy Services LLC to John Fuller, production Manager, Rumford Paper Company, cc to Scott Alley, Utilities Superintendent, Rumford Paper Company and Rick Abradi, Energy Manager, Rumford Paper Company (July 19, 2007, 5:39 PM).

³⁹ *Id.*

After consulting with Rumford operators, CES suggested and Rumford agreed that it would claim 20-30 MW of load response in the DALRP.⁴⁰ However, no contemporary written documents produced by CES or Rumford, including the White Paper, mention CES's proposal to curtail G4 during the baseline period,⁴¹ although this was a key aspect of Rumford's participation and CES does not dispute that it proposed that Rumford curtail generation during the baseline period. This lack of documentation is noteworthy given that the generation curtailment scheme and the projected revenues led Rumford personnel to question CES "on numerous occasions about the legitimacy of the program" during meetings between the companies.⁴² Regarding these concerns, Rumford's Utilities Superintendent, Scott Alley testified: "If someone comes and offers a program that supplies you with a financial benefit, and it does not look like there's a lot of downside, I think human nature is you automatically question, hey, what's up? And, you know, so we asked quite a bit about it."⁴³ Other senior managers at Rumford, Alley, Rick Abradi (Rumford's Energy Manager), and John Fuller (Rumford's Production Manager), expressed similar concerns to CES and Silkman regarding the legitimacy of Rumford's participation in the program.⁴⁴

Silkman admitted "there were some concerns [expressed by Rumford personnel] as to what the [LRP] manual means and how do you interpret the manual" regarding curtailing G4 and how Rumford should operate to establish its baseline.⁴⁵ Silkman also acknowledged that Rumford management stated to him that it appeared Rumford would be getting paid for doing nothing.⁴⁶ Explaining this reaction, Silkman testified: "I think it was just generally a lot of folks expressed a concern. It is important to remember the context in which this occurs. There are lots of ISO programs where you get paid for doing nothing . . . The idea where somehow you get paid for something has become, and

⁴⁰ Silkman Dep 171-72.

⁴¹ Silkman Dep. 239:18-24. However, in response to Enforcement data requests, Rumford produced a handwritten chart that appears to graphically demonstrate the curtailment scheme. Although Enforcement asked numerous deponents about the chart, none of whom was able to definitively identify the creator, Silkman said that the handwriting "could possibly be" his. *Id.* 245:9-11.

⁴² Alley Dep. 116:9-15.

⁴³ *Id.* at 116:9-22.

⁴⁴ *Id.* at 116-117.

⁴⁵ Silkman Dep. 324:4-13.

⁴⁶ *Id.* at 324:14-17; 326-27.

I don't want to be silly about this, but it has become sort of the commonplace understanding among customers and this is how the market works."⁴⁷

While Silkman understood that the scheme would result in payments to Rumford and CES essentially for doing nothing, he nevertheless persisted with this approach. CES did not contact Constellation or ISO-NE to explore the appropriateness of the scheme in response to Rumford senior managers' initial reservations. Setting aside Rumford's initial reservations, Rumford and CES fully adopted the Silkman baseline inflation scheme.⁴⁸

CES, representing Rumford, contacted Constellation and initiated the load response enrollment process with Constellation as Rumford's Enrolling Participant. One of the reasons CES proposed to use Constellation was that Constellation was a "large and very respected" member of New England Power Pool (NEPOOL) and that "to the extent that issues arise about interpreting ISO New England rules or dealing with [] ISO New England, having them on our side will be very helpful."⁴⁹ However, before enrolling in ISO-NE's load response programs, neither CES nor Rumford sought advice from Constellation on ISO-NE rules with respect to the DALRP generally, how to operate during the baseline period, or whether the adopted scheme of getting paid for doing nothing was legitimate.⁵⁰

Just before the baseline period, CES and Rumford personnel discussed the information that would be provided to ISO-NE to enroll Rumford.⁵¹ Although Rumford did not intend to change its operations to create a load reduction in the DALRP, CES (with Rumford's approval) communicated a claimed load response capability for Rumford of 20 MW electronically to ISO-NE.⁵²

Consistent with CES's recommendation, Rumford executed an agreement with Constellation in July 2007, permitting Constellation to enroll Rumford in the DALRP.

⁴⁷ *Id.* at 324-25.

⁴⁸ Guay Dep. 52:9-12.

⁴⁹ Rumf000001-000003. *See also* Silkman Dep. 189-90.

⁵⁰ Silkman Dep. 190:10-16. Although CES spoke with Constellation a number of times before the baseline period, neither CES nor Rumford told Constellation that Rumford intended to curtail generation during the baseline period. *Id.* at 265-66.

⁵¹ *Id.* at 174:2-7.

⁵² CES narrative Response to Data Requests at 3.

As compensation for CES's referral of Rumford to Constellation, CES received a monthly broker's fee of 5% of all revenues related to the customer's load response participation. Constellation retained 10% of all revenues and Rumford received the remaining 85%.⁵³ While not formalized in the broker agreement, CES and Constellation understood CES would act as the main point of contact for Constellation regarding Rumford's load response participation and that Constellation's direct contact with Rumford would be minimal.⁵⁴ The primary contact at CES regarding Rumford's DALRP participation was Silkman.⁵⁵

CES and Rumford Executed Silkman's Scheme

Rumford's initial five-day baseline period ran from July 24, 2007 through July 30, 2007 (excluding July 28 and 29, 2007, which were non-business days). Consistent with the agreed upon scheme,⁵⁶ Rumford curtailed generation from G4 during the baseline period.⁵⁷ Rumford managers instructed generation plant operators to reduce the generation output of G4 during the DALRP program hours of 7:00 AM through 6:00 PM.⁵⁸ Other than the generator's curtailment, Rumford operated as it otherwise would have absent DALRP participation.⁵⁹ Other than curtailing generation, Rumford did not increase its load.⁶⁰ The curtailment resulted in an atypical load pattern for each of the baseline days, with Rumford's load spiking to 30-45 MW just prior to 7:00 AM, continuing at that level until 6 PM, and dropping precipitously to 5-10 MW just after 6:00 PM.⁶¹ Alley testified that curtailment of G4 during the initial baseline period was always

⁵³ CES narrative response to Data Requests and Response to Data Request 7(b).

⁵⁴ Silkman Dep. 129-30.

⁵⁵ *Id.*

⁵⁶ CES Response to Data Requests 9 and 20.

⁵⁷ Guay Dep. 71:3-22; Alley Dep. 110:4-7. LeClaire, the most senior Rumford official at the mill, was aware of this decision. *Id.* at 110:4-7.

⁵⁸ Rumford Data Responses 36d and e.

⁵⁹ Guay Dep. 67-68; Rumford Data Response 36b.

⁶⁰ Rumford Data Response 35.

⁶¹ *See also* ISO-NE generated load profiles for Rumford Paper Company in July, August, and November 2007 (provided as Attachment C to Enforcement's first set

between 25 and “40-ish” MWs and was roughly in the 30-40 MW range overall.⁶² When questioned, Silkman admitted that Rumford “probably” would have generated more energy from G4 during the baseline period had it not participated in the DALRP.⁶³

Table 1⁶⁴ demonstrates the five-day load profile for Rumford using this scheme, including the marked increase in electricity consumption during the hours measured to calculate the baseline.

RUMFORD LOAD DURING BASELINE PERIOD

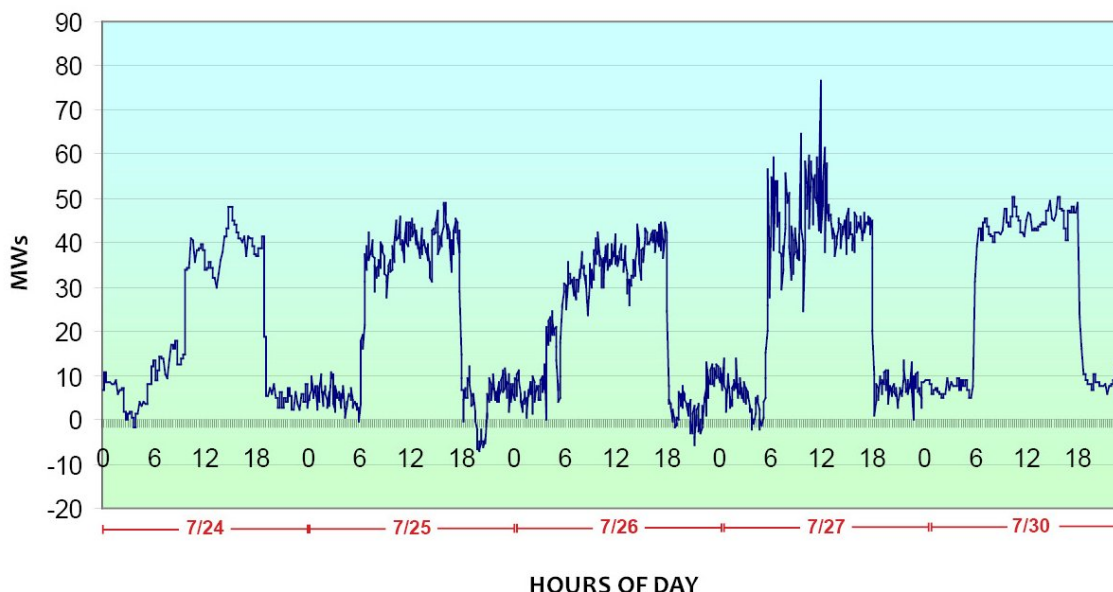


Table 1 demonstrates the increase in Rumford load during the five days relied upon by ISO-NE to establish Rumford’s baseline.⁶⁵ Just before 7:00 AM on each day, Rumford curtailed generation from G4 and load dramatically spiked. This generation

of data requests to Rumford Paper Company dated April 7, 2008) and 5-minute interval energy data, ISO-NE April 22, 2008 Data Response.

⁶² Alley Dep. 109:2-7. Alley could not recall a specific instance within the last few years (other than equipment outages) in which Rumford's purchases of energy were greater than they were during the baseline period. *Id.* at 113-14.

⁶³ Silkman Dep. 295:11-19; 207:8-12.

⁶⁴ See December 7, 2011 ISO-NE Data Response.

⁶⁵ Note that Saturday July 28 and Sunday July 29 are excluded from the chart as weekend days are not used to calculate the baseline.

curtailment continued throughout the day until just after 6:00 PM, the time when ISO-NE stopped reviewing data to calculate the baseline.

Beginning on July 31, 2007, through early February 2008, Rumford and CES submitted daily, non-holiday weekday load reduction offers for each program hour in the DALRP.⁶⁶ Consistent with the agreed-upon scheme, the daily DALRP offers were virtually always submitted at the minimum offer values (\$50.00 per MW/h for a minimum of 1 hour each day).⁶⁷ As LMP prices in ISO-NE were virtually always above \$50.00 during program hours, Rumford's offers always cleared the market and the company received DALRP revenues for each day. Rumford's inflated baseline remained unchanged. As ISO-NE compared Rumford's actual load to its inflated baseline, it appeared that Rumford was reducing load and was compensated at the relevant LMP. The only circumstances in which Rumford's offers did not clear were when: (1) CES inadvertently submitted an invalid offer; (2) Rumford expected to repair on-site equipment during the next day; or (3) ISO-NE directed Rumford to restore the baseline following a November 2007 generator outage.⁶⁸

Once the inflated baseline had been established, Rumford operated its paper mill and generation facilities the same way it had operated them before the baseline period.⁶⁹ Rumford did not increase its generation to provide demand response. Likewise, Rumford never reduced its electrical consumption as a consequence of its DALRP participation.⁷⁰ Silkman testified that typical, day-to-day fluctuations in Rumford's operations and energy usage did not require modifications to Rumford's DALRP offers.⁷¹ Silkman was aware that Rumford had no written procedures in place regarding reduction of energy consumption on days when DALRP offers were accepted⁷² and CES admits that it did not anticipate Rumford would reduce energy consumption as part of its DALRP

⁶⁶ See RUMF0000926-0000946 (spreadsheet providing Rumford's DALRP offer data); Silkman Dep. 315-16; 320:1-5.

⁶⁷ Though DALRP participants may offer a minimum of 100 kW, as explained above, they are compensated for all load reductions below the baseline at prevailing real-time LMP prices.

⁶⁸ The latter two instances are discussed below.

⁶⁹ Alley Dep. 140-41; 151:13-24.

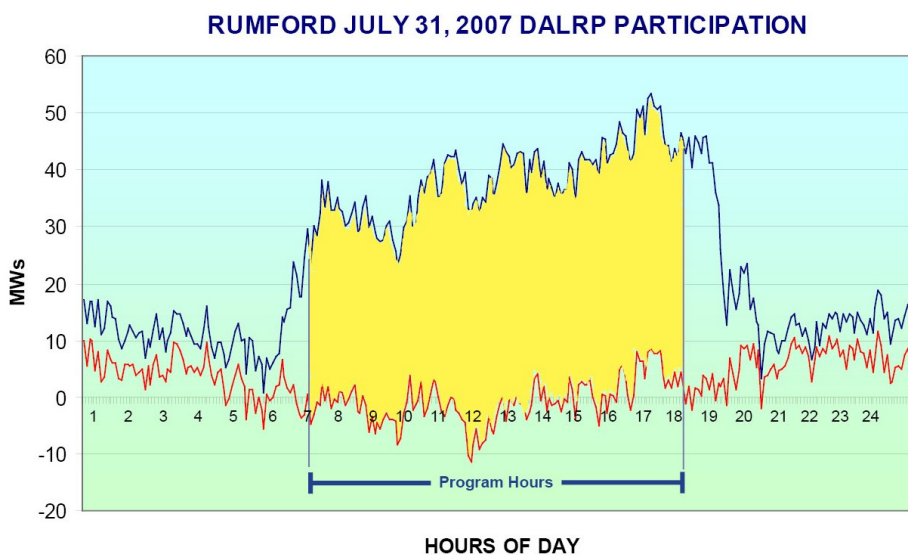
⁷⁰ Silkman Dep. 257:13-20; Alley Dep. 140:19-24.

⁷¹ Silkman Dep. 319:21-25.

⁷² *Id.* at 257-58.

participation.⁷³ Rumford's offers were communications to ISO-NE of an availability and willingness to reduce load by a specified amount at a specified price, yet Rumford and CES never intended to and never actually did reduce load when its offers cleared.

Table 2⁷⁴ compares the baseline for Rumford (the blue line) with Rumford's actual load (the red line) on July 31, 2007, Rumford's first day offering into the DALRP. ISO-NE, unknowingly relying upon an inflated baseline, compared Rumford's actual load against the baseline to calculate the amount of load purportedly "reduced" by Rumford during the program hours (the shaded area). ISO-NE paid \$36,193.37 for Rumford's phantom load response on July 31, 2007.⁷⁵



A similar pattern is reflected for virtually every day of Rumford's DALRP participation. As a result of the scheme, ISO-NE paid \$3,336,964.63 for demand response that never occurred. Of this amount, Rumford received \$2,836,419.08 and CES received \$166,841.13.

⁷³ *Id.* at 210-11.

⁷⁴ *See* December 7, 2011 ISO-NE Data Response.

⁷⁵ *Id.*

B. Analysis

CES violated § 1c.2 of the Commission's Regulations

Section 222 of the FPA prohibits the use of deceptive or manipulative devices in connection with the purchase or sale of electric energy or the transmission of electric energy subject to the Commission's jurisdiction.⁷⁶ Order No. 670 implemented this prohibition, adopting 18 C.F.R. § 1c.2 which prohibits an entity from: (1) using a fraudulent device, scheme or artifice, or making a material misrepresentation or a material omission as to which there is a duty to speak under a Commission-filed tariff, Commission order, rule or regulation, or engaging in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any entity; (2) with the requisite scienter; (3) in connection with a transaction subject to the jurisdiction of the Commission.⁷⁷ Fraud is a "question of fact that is to be determined by all the circumstances of a case."⁷⁸

- a) Fraudulent device, scheme or artifice; or engaged in any act, practice, or course of business that operates or would operate as a fraud

As to the first element under 18 C.F.R. § 1c.2, CES's actions constitute a fraudulent scheme or artifice. CES's scheme was based on misrepresentations to ISO-NE about Rumford's typical load and willingness and ability to reduce load. Because of these misrepresentations, Rumford and CES were compensated for load response that they knew would never occur, and, in fact, never occurred.

By curtailing generation and buying more grid power, CES and Rumford established and communicated to ISO-NE an inflated baseline that did not reflect Rumford's genuine load response capability, as Rumford did not intend to reduce its consumption or increase its generation once the baseline was established. As CES knew, the baseline is a critical component to determining the load reduction of load response resources and calculating load response payments. CES's submission to ISO-NE of load response registration information was also false, claiming that the mill had a DALRP load response capability of 20 MW. Additionally, by submitting daily offers to reduce

⁷⁶ 16 U.S.C. § 791A (2006).

⁷⁷ *See Prohibition of Energy Market Manipulation*, Order No. 670, 71 Fed. Reg. 4244 (Jan. 26, 2006), FERC Stats. & Regs. ¶ 31,202, 114 FERC ¶ 61,047 (Jan. 19, 2006) (Order No. 670).

⁷⁸ *See id.* at P 50.

load, CES and Rumford communicated a willingness and ability to reduce load. These communications were false because, as CES understood, Rumford was not reducing load and did not intend to reduce load as a result of its DALRP participation. Instead, CES and Rumford used the offers to perpetuate the inflated baseline. These actions defrauded ISO-NE at the expense of all rate payers in New England as the cost of demand response is socialized across all Network Load.

b) Scierter

CES conceived of the scheme and persuaded Rumford to establish an inflated baseline to participate in the DALRP. CES knew Rumford would not reduce any load when it participated in the DALRP.⁷⁹ Instead, Rumford and CES would be paid for phantom load reductions without any appreciable change in the mill's operations. CES knew such a scheme would produce no discernable benefits to the electrical grid or reduce energy prices. CES also knew that, effectively, it and Rumford would be paid by ISO-NE for doing nothing. CES and Rumford understood that Rumford would neither increase generation nor decrease electricity consumption as part of Rumford's participation. CES and Rumford intended to defraud ISO-NE.

For these reasons, Enforcement concludes that scierter is present.

c) In connection with a transaction subject to the jurisdiction of the Commission

Offers of demand response for day-ahead energy reductions are in connection with transactions subject to the Commission's jurisdiction. Section 201(b)(1) of the FPA gives the Commission jurisdiction over the sale of electric energy at wholesale in interstate commerce. Section 205(a) of the FPA confers jurisdiction to the Commission over "[a]ll rates and charges made, demanded or received by any public utility for or in connection with the ... sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges."⁸⁰ Courts have held that where a provision or term of an agreement directly and significantly affects a wholesale rate, it is within the Commission's broad discretion to

⁷⁹ See, e.g., *Silkman* Dep. 210-11; 257:13-20.

⁸⁰ Section 205(c) of the FPA also contains similar language regarding the Commission's jurisdiction to require public utilities to file rates and charges for any sale subject to the Commission's jurisdictional rates, including all classifications, practices and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications and services.

determine which practice that affect rates must be described in that rate schedule.⁸¹ Demand response has both a direct and indirect effect on wholesale rates and, indeed, the DALRP was designed precisely to affect (by lowering) wholesale prices for energy.⁸² When demand response is offered into an organized market it directly affects the wholesale rates, and is therefore a practice affecting jurisdictional wholesale rates that is subject to the Commission's jurisdiction under §§ 205(a) and (c) of the FPA.

As an ISO's markets are within the Commission's jurisdiction, ISO-operated and Commission-approved load response programs are also within its jurisdiction.⁸³ CES conceived of a fraudulent scheme for Rumford's participation in this jurisdictional program, facilitated Rumford's participation, provided misleading information to Constellation and ISO-NE regarding Rumford's participation, and profited directly from the fraud. Accordingly, staff concludes that CES's fraudulent activity was in connection with a jurisdictional transaction and violated 18 C.F.R. § 1c.2.

C. Defenses Raised by CES

CES admits that it advised Rumford to curtail generation from G4 during the baseline period and purchase additional power from Constellation. CES also admits that, working with Rumford, it submitted DALRP offers through Constellation for the minimum price of \$50/MWh between August 2007 and February 2008. However, CES disputes staff's conclusion that CES's actions were intentionally deceptive, fraudulent, and in connection with a transaction subject to the Commission's jurisdiction.

⁸¹ *City of Cleveland v. FERC*, 773 F.2d 1368, 1376 (D.C. Cir. 1985). *See also Connecticut Dept. of Public Utility Control v. FERC*, D.C. Cir. 07-1375, slip op. at 14-15 (D.C. Cir. 2009) (holding that capacity decisions about an interconnected bulk power system affect Commission's jurisdictional transmission rates for that system and are within the Commission's jurisdictional authority).

⁸² *See Wholesale Competition in Regions with Organized Electric Markets*, Order No. 719, 73 Fed. Reg. 64,100 (Oct. 28, 2008), FERC Stats. & Regs. ¶ 31,281 at P 47 (2008) (Order No. 719), *order on reh'g*, 128 FERC ¶ 61,059 (2009) (Order No. 719-A), *order on reh'g*, 129 FERC ¶ 61,252 (2009) (Order No. 719-B).

⁸³ *See* Order Nos. 719 and 719-A; *New England Power Pool and ISO New England, Inc.*, 111 FERC ¶ 61,064 (2005) (approving ISO-NE load response programs and related tariff provisions); *Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States*, 96 FERC ¶ 61,155 at 61,679, *order on clarification and reh'g*, 97 FERC ¶ 61,024 (2001). *See also Conn. Dep't of Pub. Util. Control v. FERC*, 569 F.3d 477 (D.C. Cir. 2009) (upholding the Commission's authority to review the ISO-NE Installed Capacity Requirement under the Federal Power Act).

Enforcement has reviewed all of CES's arguments and believes them to be without merit. CES's arguments are not often explicitly linked to § 1c.2's criteria. However, virtually all of CES's defenses fall into the categories discussed below.

1. CES claims that its actions were based on a good faith review of ISO-NE rules

CES claims that ISO-NE's LRP Manual provided no guidance on how to operate during the baseline period and that, without any reliable guideposts, CES provided advice to Rumford on how to set the baseline in accordance with its best understanding of the DALRP rules.⁸⁴ CES further argues that it expected Rumford would "regularly [] curtail electricity load to satisfy its bid obligations under the DALRP"⁸⁵ and that under CES's understanding of the program, the essential question was determining the level of generation necessary to safely operate the paper mill, and to set the baseline so that only that excess generation was made available under the DALRP. In fact, CES argues that Rumford was effectively required to artificially set its baseline; that it "had to set its baseline *somewhere*."⁸⁶ This involved, according to CES, setting generation to "simulate" then non-existent market conditions: namely, "a situation where market prices were low."⁸⁷

These arguments are specious. There is no contemporary evidence that Rumford and CES believed actual load response would be required under the adopted scheme. In fact, as discussed above, the investigative record demonstrates the opposite: Rumford and CES knew that they would be paid for doing nothing. Further, CES cannot explain why it needed to "set" a baseline that was designed to change to reflect actual variations in the mill's load.⁸⁸ Setting a baseline at an artificial quantity is inconsistent with the DALRP requirement that actual load be used for baseline calculations. Finally, it is implausible that Silkman or CES believed that legitimate participation by an industrial demand response participant was conditioned upon \$120,000 in uneconomic energy purchases

⁸⁴ See CES 1b.19 Response at 17 and 21.

⁸⁵ CES 1b.19 Response at 21.

⁸⁶ *Id.* at 16 (emphasis original).

⁸⁷ Silkman Dep. 265-66.

⁸⁸ LRP Manual, § 4.2.1.

during the baseline period. CES has not provided any contemporary evidence that CES actually interpreted the DALRP so as to require the setting of an artificial baseline.⁸⁹

CES also claims that, while Rumford did not have to reduce load to be paid for DALRP load response, CES initially believed that Rumford would need to “shed load in the program.”⁹⁰ This assertion is inconsistent with statements made under oath by Rumford managers. When CES briefed Rumford on its proposal to create an artificial baseline, Rumford personnel understood there would be no genuine risk to participation,⁹¹ that there would be no benefit to the grid,⁹² and, most tellingly, that the proposal sounded as if Rumford and CES would be getting paid for doing nothing.⁹³ Had CES truly thought that Rumford would have to regularly reduce load under its scheme (either by reducing consumption or increasing generation), the participants in these meetings would not have believed that the proposal sounded “too good to be true.”⁹⁴

2. CES claims that providing DALRP advice to Rumford was very complex

CES states that directing Rumford’s DALRP participation was “an enormously complex undertaking” because of the physical characteristics of the mill and the fact that the mill’s energy needs and fuel costs fluctuated hourly.⁹⁵ CES cites a 2008 ISO-NE tariff filing explaining that some baseline methodologies for demand response programs

⁸⁹ In its submissions, CES often misstates the operation of the DALRP. For example, CES argues “[s]ince no one was ever asked to reduce load, the DALRP can be made to appear in retrospect as payment for ‘doing nothing,’ but the actual payment was for being available to interrupt load.” CES 1b.19 Response at 40. This statement is a straw man. The DALRP did not pay participants for their “availability to interrupt load.” The DALRP paid participants who *actually* reduced load. Participants were required to reduce load when they made offers to reduce load and those offers were accepted. Since Rumford offered to reduce load and those offers were accepted, Rumford was required to reduce load every day.

⁹⁰ *Id.* at 23.

⁹¹ Silkman Dep. 258-59.

⁹² Alley Dep. 68:14-24; 67:5-11.

⁹³ *See, e.g., id.* at 116:9-15.

⁹⁴ *Id.* at 117:3-7.

⁹⁵ CES 1b.19 Response at 2.

are complex.⁹⁶ Because of this alleged complexity, CES essentially claims that its actions cannot be deemed fraudulent.

CES misstates the complexity of the DALRP and the scheme proposed by CES. First, while some demand response baseline mechanisms are complex, the DALRP baseline process was not. The initial DALRP baseline was calculated using a participant's actual load in the program hours for five days. There is no evidence that CES misunderstood the baseline calculation process.

Second, CES's proposed scheme was easily understood: reduce generation when ISO-NE measures baseline load to establish an inflated baseline, return to typical operation after a baseline is established, submit uniform offers to reduce load each day, and receive payment for phantom load reductions. While CES now claims that Rumford's load profile required a complicated curtailment scheme and large uneconomic purchases of energy to set a baseline, there is no contemporary evidence backing up this assertion. CES did not engage in any complex analysis of Rumford's load or research how to set an artificial baseline based on a difficult "simulation" of hypothetical market conditions. CES's conduct was not the result of confusion or mistake; it was deliberate, calculated fraud.

3. CES claims that flaws in the DALRP caused the static baseline

CES argues that the perpetuation of Rumford's static baseline was the result of a flawed DALRP program rather than a scheme to defraud ISO-NE. CES asserts that once the baseline was originally established, CES submitted DALRP offers to Constellation in Rumford's name for the minimum price of \$50/MWh. Because ISO-NE did not change the minimum offer price, and because the market price generally did not fall below \$50/MWh, Rumford's offers were accepted each day.⁹⁷ CES claims that this conduct did not violate ISO-NE's tariff, and therefore the company is insulated from any finding that it violated § 1c.2.⁹⁸

Silkman admitted he understood that energy prices in New England had increased and that there was the possibility DALRP customers could offer successfully into the DALRP every day, resulting in a static baseline.⁹⁹ Silkman also acknowledged that "the

⁹⁶ *Id.* at 20-21 (quoting *ISO New England, Inc.*, 123 FERC ¶ 61,021 at P 29 (2008)).

⁹⁷ *Id.* at 31-34.

⁹⁸ *Id.* at 1.

⁹⁹ Silkman Dep. 412:11-413:8.

inability to adjust [the] baseline on an ongoing basis creates some potentially perverse results”¹⁰⁰ including allowing ISO-NE to “pay for load that is not really interrupted.”¹⁰¹ Although Silkman could not specifically recall telling Rumford that the baseline would not change if DALRP energy offers were accepted, he admitted it was likely that he had.¹⁰²

CES cites the fact that ISO-NE later modified the DALRP to ensure that baselines were more likely to include updated load data, but this modification does not provide any defense to CES’s conduct. The investigative record shows that during the period in question CES and Rumford chose to use high energy prices in New England as an opportunity to implement a scheme to receive demand response payments without providing any load reduction.

Enforcement also notes that, while ISO-NE’s tariff did not specifically prohibit CES’s scheme, section 1c.2 applies regardless of whether a tariff specifically prohibits a certain form of conduct.¹⁰³ Conduct that may not conflict with a tariff may nonetheless be part of a fraudulent scheme.

4. CES claims that Constellation was fully aware of Rumford’s baseline activities and that fact exonerates CES

CES claims that its actions in the DALRP were not fraudulent because Constellation was fully aware of Rumford’s actions. This argument is not persuasive.

As a threshold matter, whether Constellation employees could have deduced CES’s behavior is not relevant to the question of whether CES engaged in fraud. CES deceived and defrauded ISO-NE. Constellation’s alleged knowledge of CES’s behavior, even if true, would not absolve CES or Rumford of their deception of ISO-NE and the harm caused to all New England rate payers.

¹⁰⁰ *Id.* at 92:17-19.

¹⁰¹ *Id.* at 92-93.

¹⁰² *Id.* at 243:16-21.

¹⁰³ For example, CES asserts that submitting DALRP offers at the minimum offer price of \$50.00 per MWh was permitted by the ISO-NE tariff. *See* CES 1b.19 Response at 32-33. Staff does not allege that the offers, in isolation, violate § 1c.2. Rather, the scheme was fraudulent because CES used these offers to perpetuate an inflated baseline, allowing it to repeatedly claim payment for load reductions that did not occur.

As a factual matter, CES never told Constellation of its scheme or even that Rumford curtailed generation during the baseline period. However, CES claims more generally that Silkman and Constellation discussed Rumford's baseline "on at least three occasions."¹⁰⁴ In a strict sense, this statement is true, as CES and Constellation discussed the timing of the baseline and other procedural aspects of Rumford's initial DALRP participation. However, CES admits that it never disclosed to Constellation the fact that Rumford curtailed generation during the baseline period or that Rumford had an inflated baseline.¹⁰⁵ Internal, contemporaneous Constellation documents indicate that Constellation was unsure how Rumford was participating in the DALRP¹⁰⁶ and the sworn testimony of Constellation employees is consistent on this point.¹⁰⁷ Staff asked CES to produce all documents relevant to its contention that CES discussed the baseline with Constellation. CES produced no responsive materials.¹⁰⁸ Simply put, there is no credible written or oral evidence that CES clearly told Constellation how Rumford operated during the baseline period.¹⁰⁹ CES's focus on a Constellation data response on this point is misplaced.¹¹⁰

¹⁰⁴ *Id.* at 8.

¹⁰⁵ *See, e.g.*, Silkman Dep. 260:7-15 ("Q. On your application did you state or did Rumford state that it was curtailing generation during the baseline period? A. There was no reason to state that on the application."); *accord* Silkman Dep. 265:16-22 ("Q. Prior to the time in which the baseline was set, did you or anyone else at Rumford contact Constellation and explicitly tell them that Rumford intended to curtail generation during the baseline period? A. I'm not sure what you mean by explicitly . . ."); *accord* Silkman Dep. 266:15-21 (Q. . . . Looking at only the time period before the baseline was set, do you recall using the word curtailment in any conversations that you had with Constellation regarding participation in the load response programs? A. I don't recall that word, no."); *accord* Silkman Dep. 366:12-17 ("Q. Did Amy [Richard of Constellation] ever ask you specifically if you had recommended that Rumford turn off generation during the baseline period? A. I don't recall her asking. If she had I would have told her because that is how we did it, but I don't recall her asking that question specifically.").

¹⁰⁶ *See, e.g.*, Constellation Data Response 18 (and revised response).

¹⁰⁷ *See, e.g.*, Richard Dep. 85:21-24; 91:18-92:7.

¹⁰⁸ *See* CES's February 16, 2010 Data Response 7.

¹⁰⁹ CES focuses on an August 2007 meeting with Constellation as support for its position that CES told Constellation how Rumford's baseline was established. In fact, Constellation called the meeting because it had concerns about Rumford's participation and was uncertain as to how exactly Rumford had participated in the

Further, CES's position is inconsistent with later events. In January 2008, CES received a phone call from Peter Kelly-Detwiler, a Senior Vice-President at Constellation.¹¹¹ Silkman stated that Kelly-Detwiler informed Silkman that Constellation would soon be sending a letter to all of Constellation's DALRP customers, including Rumford, outlining concerns Constellation had developed regarding the program.¹¹² Silkman testified that Kelly-Detwiler indicated in this phone conversation that the letter was sent at the direction of Constellation's legal department, and that it was not specifically directed to CES's DALRP clients.¹¹³ Within twenty-four hours of this conversation, Silkman contacted Rumford counsel Ron Guay and informed him that the letter sent by Constellation "was not directed to Rumford's participation."¹¹⁴

Constellation provided CES an advance copy of the letter which stated that Constellation was "concerned that some of our Day-Ahead Program customers may have increased their usage while ISO-NE was determining their baselines, possibly due to changed production schedules or on-site generation outages. If baseline usage is

program including the establishment of Rumford's baseline. Richard Dep. 49:2-8. Constellation employees, including account manager Amy Richard, testified that while Constellation and CES discussed Rumford's DALRP participation during this meeting, CES never clearly explained that Rumford curtailed generation during the baseline or that the baseline had been inflated. *Id.* 79-80. In fact, CES's explanation regarding Rumford's participation was unclear, lacking any detail, and confusing, and Richard remained concerned about Rumford's participation following this meeting.

¹¹⁰ CES argues that the testimony of Constellation personnel is inconsistent with an initial Constellation data response where Constellation stated CES told it that "Rumford shut down its boiler and turbine in order to increase its baseline." *See* Constellation Data Response 18 (and revised response). *See also* CES 1b.19 Response at 3 (referencing Constellation Data Response 18). In response to further questioning by staff regarding this statement, Constellation corrected and clarified the response. All Constellation employees deposed by staff stated that CES never explicitly disclosed it had advised Rumford to create an artificial baseline by curtailing generation during the baseline period.

¹¹¹ Silkman Dep. 385:5-18.

¹¹² *Id.* at 385:11-18.

¹¹³ *Id.* at 385-86.

¹¹⁴ *Id.* at 391:14-24; 392:11-15.

‘inflated’ in this manner, bids into the Day-Ahead Program may reflect a customer’s normal usage rather than dispatchable load that ISO-NE can depend upon for reliability purposes.”¹¹⁵ When pressed, Silkman testified that the language in the letter regarding customers’ inflated baselines did not cause CES concern as Constellation had indicated that the letter was not directed specifically to Rumford or other CES clients.¹¹⁶ CES did not contact anyone at ISO-NE or Constellation to discuss the content of the letter.¹¹⁷

CES’s reaction to Constellation’s letter and call from a Constellation Vice-President is inconsistent with CES’s claim that Constellation was aware of the baseline inflation scheme. The letter clearly indicated that inflated baselines were impermissible and that participants should not be paid for “normal usage.” Had CES previously told Constellation that generation was curtailed during the baseline period (creating an inflated baseline) or that Rumford was being compensated for “normal usage,” one would expect a much different reaction by Silkman and CES. At the very least, one would expect Silkman and CES to remind Constellation that it had allegedly permitted and approved the scheme and seek further discussions with Constellation.

In fact, Silkman, CES, and Rumford were aware that ISO-NE viewed the scheme as fraudulent *before* Constellation sent its letter. On January 21, 2008, Silkman forwarded to Rumford managers Abradi and Guay a January 16, 2008 presentation by ISO-NE on concerns that ISO-NE had developed regarding the DALRP.¹¹⁸ In his cover e-mail, Silkman stated that ISO-NE was contemplating changes to the DALRP: “The problem with this is that there will be many days in which the clearing price does not get above the minimum bid, which will result in an adjustment to the Baseline.”¹¹⁹ He also highlighted the fact that the attached presentation shows the “concern that ISO-NE has” about the DALRP.¹²⁰ The ISO-NE PowerPoint presentation describes precisely the scheme adopted by Rumford and CES: “several Market Participants appear to have figured out how to benefit from the creation and maintenance of a static [baseline]” by “intentionally inflating their [baseline]. This is done by increasing consumption or by decreasing the output of behind-the-meter generation when building the CB [baseline],

¹¹⁵ See Rumf0001701-02; Silkman Dep. 397:3-9.

¹¹⁶ Silkman Dep. 398-99.

¹¹⁷ *Id.* at 396:3-12; 399:4-14.

¹¹⁸ Rumf0001495-0001497.

¹¹⁹ Silkman Dep. 396:3-12; 399:4-14.

¹²⁰ *Id.*

and by submitting a \$50.00/MWh offer (which would clear in today's market) and returning to normal operations for every day thereafter."¹²¹

5. CES claims that G4 outages during DALRP participation demonstrate good faith

CES claims that during September and November 2007, Rumford and CES elected not to take advantage of outages of G4 to further increase the baseline, demonstrating that CES did not act in the DALRP with intent to defraud. CES argues that in September 2007, Rumford and CES submitted DALRP offers of 1 MW during a G4 outage, although, if they had instead chosen not to submit DALRP offers during the outage the baseline would have increased.¹²² Further, CES argues that in November 2007 during another G4 outage, CES sought Constellation's advice on how to participate in the DALRP during this outage and Constellation spoke to ISO-NE staff who advised Constellation to reset Rumford's baseline in order to return the baseline to the level Rumford originally set when it joined the DALRP in July 2007.¹²³ CES states that Silkman felt "vindicated" when ISO-NE provided direction that reestablished the original baseline.¹²⁴ Staff disagrees with CES's arguments.

Regarding the September 2007 event, data submitted by Rumford (and cited by CES) indicates that CES's description of the September event is faulty. It appears that Rumford and CES actually reaped substantial unjust profits for phantom load reductions during the September outage. By offering 1 MW for each program hour during the unexpected outage of G4, Rumford and CES received DALRP compensation for 1 MW of demand response at the relevant Day-Ahead price and additional DALRP deviation payments paid at the generally higher Real-Time price. In fact, according to the data provided, during this time Rumford was compensated in some hours for over 70 MW of demand response that did not occur.¹²⁵ Rumford's 1 MW hourly offers on September 13,

¹²¹ RUMF0002828; PowerPoint Presentation by Henry Yoshimura of ISO-NE regarding Day-Ahead Load Response Program (DALRP) Recommended Market Rule Changes at 9 (January 23, 2008).

¹²² CES 1b.9 Response at 28.

¹²³ *Id.* at 29-30.

¹²⁴ *Id.*

¹²⁵ See LONDONECON060610-14. For example, on hour 18 on September 13, 2007, Rumford offered 1 MW of load response into the DALRP. Because of its inflated baseline (and, apparently, reduced mill operations during the G4 outage), Rumford showed a load response of 72.132 MW during this hour.

2007 were particularly lucrative, with Rumford receiving \$33,238.36 for demand response that day.¹²⁶ This compares with Rumford's \$24,484.26 average daily payment for DALRP program days.¹²⁷

Regarding the November outage, ISO-NE's advice to reset the baseline to its preexisting level does not provide a defense.¹²⁸ CES did not tell ISO-NE that Rumford curtailed generation during the initial baseline period. Because ISO-NE did not know Rumford's initial DALRP baseline was inflated, it was understandable for ISO-NE to instruct Rumford to reset its baseline to the original level that ISO-NE presumed to be legitimate. ISO-NE's advice does not disprove CES's fraud, or justify its behavior.

6. CES argues that the Commission lacks enforcement jurisdiction

CES acknowledges the Commission has jurisdiction over the DALRP and load response participants.¹²⁹ However, CES attempts to argue its conduct here falls outside of the Commission's jurisdiction based on a pre-EPA 2005 case, *Automated Power Exchange, Inc. v. FERC*, 204 F.3d 1144, 1153 (D.C. Cir. 2000), holding that the Commission does not have general jurisdiction over all participants in the wholesale power industry.¹³⁰ Further, CES argues that the FPA does not give authority to the Commission to pursue fraud allegations against entities that merely "aid and abet" others. CES cites precedent related to Securities and Exchange Commission enforcement under § 10(b) of the Securities and Exchange Act of 1934 (1934 Act), 15 U.S.C. § 78j(b).¹³¹

CES largely ignores the relevant FPA and regulatory language. The operative question is not whether the Commission has jurisdiction over "advisors," but whether CES is an "entity" that engaged in fraudulent activities "in connection with" a transaction subject to the Commission's jurisdiction.¹³² The Commission made clear in Order No.

¹²⁶ See December 7, 2011 ISO-NE Data Response.

¹²⁷ *Id.*

¹²⁸ The ISO-NE employee who spoke with Constellation and Silkman confirmed he was not told that the baseline was inflated or that Rumford experienced a similar outage in September 2007. See Robert Burke Aff., August 2008.

¹²⁹ CES 1b.19 Response at 64.

¹³⁰ *Id.* at 64.

¹³¹ *Id.* at 47-51.

¹³² 18 C.F.R. § 1c.2 (2011).

670 that “if any entity engages in manipulation and the conduct is found to be ‘in connection with’ a jurisdictional transaction, the entity is subject to the Commission’s anti-manipulation authority.”¹³³ The Commission stated that the term “any entity” is “deliberately inclusive” and demonstrates Congressional intent to include any person or form of organization, regardless of its legal status, function, or activities.¹³⁴

CES and Silkman did not merely aid and abet Rumford’s fraud, but rather actively developed, participated, and benefitted from the fraud in conjunction with Rumford. Silkman and CES conceived of the scheme to defraud ISO-NE and New England rate payers. They recruited Rumford to join in this scheme. They helped to implement the scheme by communicating false and misleading information to ISO-NE. Further, CES’s percentage-based profit from the scheme was directly tied to the scheme’s success. Under these circumstances, Silkman and CES independently violated section 1c.2 of the Commission’s regulations.

IV. SANCTIONS

A. Civil Penalty

Seriousness Factors

CES’s violations fall under the Penalty Guidelines’ Chapter Two category guideline for tariff and regulation violations (§ 2B1.1). The Penalty Guidelines consider the gain to the organization or the loss caused by the violation, and either the amount of energy involved in the violation or the duration of the violation, whichever is greater. The following findings relating to the seriousness of CES’s violation guide staff’s application of the Chapter Two guideline:

¹³³ Order No. 670 at P 16.

¹³⁴ *Id.* at P 18. In *Amaranth Advisors, L.L.C., et al.*, 120 FERC ¶ 61,085 at P 49 (2007) (quoting Order No. 670 at P 18), the Commission further explained that Order No. 670, “interpret(s) the statutory phrase ‘any entity’ . . . include[s] any company or firm, and natural persons as well who, ‘intended to affect, or have acted recklessly to affect, a jurisdictional transaction.’” Interpreting the jurisdictional phrase “in connection with,” the Commission found its meaning as “encompassing situations in which there is a nexus between the fraudulent conduct of an entity and a jurisdictional transaction.” In committing the fraud, the entity must have “intended to affect, or have acted recklessly to affect, a jurisdictional transaction.” Order No. 670 at P 20-22. The Commission later determined that Part 1c of its regulations is “an intentionally broad proscription against all kinds of deception, manipulation, deceit, and fraud.” *Amaranth Advisors, L.L.C., et al.*, 120 FERC ¶ 61,085 at P 45 (2007).

- CES's violation resulted in a loss of \$3,336,964.63 to electricity customers in New England (i.e., the amount paid by Network Load for Rumford's phantom load response).
- CES's violation lasted for a period greater than 50 days, but less than 250 days.

Culpability

The Penalty Guidelines consider a variety of factors to derive a culpability score. The following findings relate to CES's culpability and guide application of the Penalty Guidelines to derive a culpability score:

- CES high-level personnel and substantial authority personnel participated in and condoned the violation.
- CES does not have a prior history of violations before the Commission or other enforcement agencies.
- CES did not engage in obstruction of justice.
- CES has fully cooperated with the investigation.
- At the time of its violation, CES lacked an effective compliance program.

Regarding the compliance program factor, CES had no effective compliance program regarding matters under the jurisdiction of the Commission. CES admits that it had no policy regarding complaints or compliance issues within the company.¹³⁵ Instead, CES states that employees at CES understood that they could raise concerns regarding the legality of the company's actions to the partners of the LLC and partners could seek out legal counsel to address their concerns.¹³⁶ There were no procedures in place to detect violations, no training of employees regarding the regulatory requirements governing energy markets, and no individual ultimately responsible to ensure compliance.

Even smaller companies, like CES, should have basic policies in place to ensure that employees act in a manner consistent with the Commission's regulatory requirements. This is particularly true in the case of CES, a company that holds itself out as an expert consultant on Commission markets and ISO-NE programs. Companies may

¹³⁵ Silkman Dep. at 345:5-11.

¹³⁶ *Id.* at 345:9-20.

receive partial credit for “effective, yet imperfect, compliance programs,”¹³⁷ but CES did not meet the criteria for partial credit: (1) active engagement and leadership by senior management; (2) effective preventive measures; (3) measures for the prompt detection and cessation of violations and voluntary reporting of violations; and (4) measures for remediation of the misconduct.¹³⁸ CES lacked an effective compliance program covering activities subject to the Commission’s jurisdiction and Enforcement believes it should not receive credit for a compliance program.

Staff recommends a civil penalty of \$7.5 million. CES’s behavior is particularly problematic since the company holds itself out as providing expert energy consulting services in Commission-jurisdictional markets. Further, the individuals and entities harmed by CES’s behavior (i.e., all persons paying for Network Load in New England, including retail rate payers) are unable to independently police and defend against this type of fraud. Under these circumstances, Enforcement believes that a civil penalty of \$7.5 million within the Penalty Guidelines’ range is appropriate.

B. Disgorgement

The entirety of CES’s DALRP Rumford-related revenue (CES’s commission for brokering phantom load reductions) from July 2007 through February 2008 was fraudulently obtained. Consequently, staff believes CES should disgorge \$166,841.13 in unjust profits, plus interest under § 35.19(a) of the Commission’s regulations.

C. CES’s Arguments Regarding Sanctions

CES disagrees with the imposition of a civil penalty as calculated under the Penalty Guidelines. CES claims civil penalties in the range would bankrupt CES¹³⁹ and the civil penalty would exceed “virtually every market manipulation case previously considered by the Commission.”¹⁴⁰ Regarding the Penalty Guidelines’ methodology, CES argues that: CES’s net gain should be used as a violation level factor, not ISO-NE’s loss of over \$3.3 million;¹⁴¹ the duration of the violation was the five days of baseline

¹³⁷ Penalty Guidelines at P 4.

¹³⁸ *Id.* at P 116.

¹³⁹ *Id.* at 66-67, 70, and 75.

¹⁴⁰ *Id.* at 67 and 70-71.

¹⁴¹ *Id.* at 71-72. CES also argues that ISO-NE suffered no loss from Rumford’s DALRP participation.

creation rather than the entirety of Rumford's participation in the DALRP;¹⁴² it should be accorded a 1 point culpability score deduction for settlement as the company should not be penalized for staff's "hard-line" settlement position.¹⁴³

Regarding disgorgement, CES argues that, although CES received \$166,841.13 from the DALRP, overhead and other general expenses lowered the profit from the DALRP to approximately \$26,000.¹⁴⁴ Regarding interest on the amount disgorged, CES argues that interest should accrue only until the time that staff began its investigation.¹⁴⁵

Staff disagrees with CES's arguments regarding the proper application of the Penalty Guidelines and believes that its calculation of the penalty range is accurate. Regarding disgorgement, staff believes that the entirety of the revenue fraudulently received by CES should be disgorged and CES should not be permitted a deduction for overhead and other expenses (which CES has not proven in any event). Likewise, interest should accrue on the amount disgorged from the time of receipt of the revenues consistent with the methodology in 18 C.F.R. § 35.19(a) and Commission precedent.

CES argues that it would only be able to pay a civil penalty up to \$166,000.¹⁴⁶ CES makes much of the fact that it has limited retained assets. Like most limited liability companies, CES does not retain profits, but regularly distributes profits to members.¹⁴⁷ CES has been a successful business since its formation in 2000, becoming the largest electricity aggregator in Maine by 2001¹⁴⁸ and expanding to service Texas customers in 2002.¹⁴⁹ CES had substantial revenues and ordinary business income (i.e., income after

¹⁴² *Id.* at 72.

¹⁴³ *Id.* at 74.

¹⁴⁴ *Id.* at 69.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* at 75. CES's response provides only a single sentence summarizing the company's 2010 revenues and profits and a conclusion that "Staff's proposed penalty is . . . significantly above CES's economic value as a company."

¹⁴⁷ Silkman Dep. 38:11-17; 65:2-9.

¹⁴⁸ Application for License as a Competitive Electricity Provider of Competitive Energy Services, L.L.C., Maine Public Utilities Commission, Docket No. 2001-4183, at p. 11 (July 12, 2001).

¹⁴⁹ Silkman Dep. 33:18-23; 61:9-11. In 2009, CES informed staff that it had sold its Texas division and distributed the proceeds to its members.

business expenses) in 2007 and 2008 during the time of the violations.¹⁵⁰ From 2006 through 2009, CES distributed much of this profit to its members.¹⁵¹ Staff has reviewed financial information provided by CES and found that the company should be able to pay a \$7,500,000 civil penalty by foregoing future profits for a time and requiring contributions from its members (who have received substantial profit distributions in the past, during the fraud, and while this investigation was pending). CES has not made a credible argument to the contrary. However, Enforcement would not oppose permitting CES to pay the proposed penalty over a multi-year period.

V. RECOMMENDED ACTION

Based on the above, Enforcement recommends the Commission issue CES an Order to Show Cause why it did not violate 18 C.F.R. § 1c.2 (2011) in connection with CES's fraudulent participation in the DALRP, and why the Commission should not require CES to pay a civil penalty of \$7,500,000 and disgorge \$166,841.13 plus interest. Enforcement also recommends the Commission make this Report public pursuant to 18 C.F.R. § 1b.20 and afford CES the opportunity to respond to staff's findings.

In accordance with 18 C.F.R. § 385.213, Enforcement recommends the Commission direct:

(a) CES, within 30 days of the date of an Order to Show Cause, be required to file an answer showing why it should not be found to have violated 18 C.F.R. § 1c.2 with respect to CES's participation in ISO-NE's DALRP.

(b) CES, within 30 days of the date of an Order to Show Cause, be required to file an answer showing why the Commission should not issue a notice of proposed penalty pursuant to the Commission's authority under § 316A of the Federal Power Act (16 U.S.C. 825o-1) in the amount of \$7,500,000, and require it to disgorge all payments received as a result of participation in ISO-NE's DALRP.

(c) Enforcement, within 30 days of the date of CES's response, be required to file an answer to CES's answer.

¹⁵⁰ CES000164-000187 (CES tax returns for 2007 and 2008). CES's profit during this time was equally substantial. Silkman Dep. 353:8-21; 354:9-13.

¹⁵¹ CES000126-198.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Competitive Energy Services, LLC

Docket No. IN12-12-000

(Issued July 17, 2012)

LaFLEUR, Commissioner, *concurring*:

I join the majority in directing Competitive Energy Services, LLC (CES) to show cause why the conduct that is the subject of this case does not constitute fraud and why it should not be required to pay disgorgement and a civil penalty.

As I explain more fully in my concurrence in *Rumford Paper Company*,¹ issued concurrently with this order, I believe that the majority's application of the Penalty Guidelines² in this case double counts the duration of CES' alleged fraud. First, the Guidelines increase CES' violation level based on the cumulative value of the monetary loss, which is directly attributable to the duration of the alleged scheme. Second, the Guidelines include a separate duration adder that increases CES' violation level according to the number of days the fraud persisted. Thus, duration is counted twice.

I believe that applying the duration factor to increase a base penalty is appropriate when duration measures the impact of the alleged violation in a manner not already captured by the Guidelines. However, I do not believe duration has independent value here. I believe the majority should have exercised its inherent discretion to apply the Penalty Guidelines without the separate duration adder, which yields a range of \$1,680,000-\$3,360,000, and proposed a civil penalty from within this corrected range.

Accordingly, I respectfully concur.

Cheryl A. LaFleur
Commissioner

¹ *Rumford Paper Company*, 140 FERC ¶ 61,030 (2012).

² *Enforcement of Statutes, Orders, Rules, and Regulations*, 132 FERC ¶ 61,216 (2010).

Document Content(s)

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