

140 FERC ¶ 61,031  
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.

Lincoln Paper and Tissue, LLC

Docket No. IN12-10-000

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,<sup>1</sup> the Commission's Revised Policy Statement on Enforcement,<sup>2</sup> and the Commission's Statement of Administrative Policy Regarding the Process for Assessing Civil Penalties,<sup>3</sup> 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).<sup>4</sup> Lincoln Paper and Tissue, LLC (Lincoln 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 \$4,400,000, or a modification of that amount consistent with section 31(d)(4) of the FPA, and disgorge \$379,016.03 of payments received as a result of participation in the DALRP (plus interest).<sup>5</sup> Pursuant to Rule 213(a) of the Commission's Rules of Practice and Procedure,<sup>6</sup> the Commission directs Respondent to file an answer with the

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<sup>1</sup> 18 C.F.R. § 385.209(a)(2) (2011).

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

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

<sup>4</sup> 18 C.F.R. § 1c.2 (2011); 16 U.S.C. § 824v(a).

<sup>5</sup> 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."

<sup>6</sup> 18 C.F.R. § 385.213(a) (2011).

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).<sup>7</sup> The OE Staff Report alleges that employees of the Lincoln paper mill in Lincoln, Maine, developed a fraudulent scheme in connection with Lincoln's participation in ISO-NE's DALRP. Specifically, OE Staff alleges that Lincoln adopted and implemented a plan to inflate Lincoln's baseline load and then repeatedly offered 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 Lincoln curtailed generation during the baseline period, intentionally creating a misleading baseline. Further, OE staff alleges that Lincoln offered load response on a daily basis, fraudulently communicating a willingness and ability to reduce load. The OE Staff Report alleges that Lincoln understood that the mill 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.<sup>8</sup> This order also is the notice of proposed penalty required pursuant to section 31 of the Federal Power Act (FPA).<sup>9</sup> 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 assessment, and if the Commission finds a violation, the Commission

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<sup>7</sup> 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 proposed sanctions.

<sup>8</sup> 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. Under Rule 213(e)(2), 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) (2011).

<sup>9</sup> 16 U.S.C. § 823b(d) (2006).

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*.<sup>10</sup>

4. The Commission authorizes OE staff to disclose information obtained in 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 (2011), 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 Lincoln'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 (2011), showing cause why its alleged violation should not warrant the assessment of civil penalties in the amount of \$4,400,000, or a modification of that amount consistent with section 31(d)(4) of the FPA, and require it to disgorge \$379,016.03 of payments received as a result of participation in ISO-NE's DALRP plus interest.

(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*.

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<sup>10</sup> 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 LaFluer concurring with a separate statement attached.

( S E A L )

Kimberly D. Bose,  
Secretary.

# APPENDIX A

Enforcement Staff Report re: Lincoln Paper and Tissue, LLC



**FEDERAL ENERGY REGULATORY COMMISSION**

**Lincoln Paper and Tissue, LLC**

**Enforcement Staff Report and Recommendation**

Office of Enforcement  
Division of Investigations

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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 Lincoln Paper and Tissue, LLC (Lincoln) in connection with Lincoln's participation in ISO New England, Inc.'s (ISO-NE) Day-Ahead Load Response Program (DALRP).<sup>1</sup>

## I. EXECUTIVE SUMMARY

Enforcement recommends that the Commission issue an Order to Show Cause and Notice of Proposed Penalty to Lincoln requiring it to show cause why it did not violate § 1c.2 of the Commission's regulations in connection with its participation in ISO-NE's DALRP, should not pay a civil penalty in the amount of \$4,400,000, and should not disgorge \$379,016.03 in unjust profits (all payments received as a result of participation in ISO-NE's DALRP).

Lincoln employees conceived a scheme to defraud ISO-NE of demand response payments. Specifically, President and CEO Keith Van Scotter, along with other senior managers, deliberately curtailed internal generation at the mill by approximately 3 MW during the five-day period when Lincoln's initial baseline load was established for the DALRP. Instead of operating the generator to supply Lincoln with virtually all of its energy needs (as was typical for the facility), Lincoln curtailed the generator and purchased replacement energy during the baseline period at a \$10,000 cost. By purchasing energy, instead of producing it on-site, Lincoln 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 Lincoln to claim load reductions (the difference between its baseline load and its normal operations) without actually reducing any load. For over six months in 2007 to 2008, Lincoln engaged in a scheme that ensured the baseline never appreciably changed. Because of Lincoln's behavior, electricity consumers in New England paid \$445,901.21 for demand response that never occurred. Of this amount, Lincoln received \$379,016.03 in revenues.<sup>2</sup>

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<sup>1</sup> Citations in this Report are to documents obtained and sworn testimony developed during Enforcement's nonpublic investigation. Citations to most documents refer to the entity supplying each document and the electronic or physical bates stamp (*e.g.*, LINC000688) and transcript references refer to the last name of the deponent, page, and line of the relevant transcript (*e.g.*, Van Scotter Dep. 30:5-20). All cited documents and transcripts are available for Commission review.

<sup>2</sup> See Constellation0023813. Lincoln received these profits during its August 1, 2007 through February 6, 2008 DALRP participation.



Staff's investigation of Lincoln and other ISO-NE demand response participants included nine depositions and multiple sets of data requests and responses. Lincoln was informed both orally and in writing of staff's views, and was invited to supplement information provided to staff. Lincoln had the opportunity to present any alternate views or defenses. Staff fully considered Lincoln's submissions.

Staff engaged Lincoln in settlement negotiations, but was unable to reach an agreement. On July 5, 2011, staff provided Lincoln 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. Lincoln responded on August 4, 2011. That response (which includes as attachments Lincoln's prior responses) is being provided to the Commission with this Report.<sup>3</sup> Lincoln argues, among other things, that Lincoln did not violate § 1c.2 of the Commission's regulations and that Lincoln's behavior is consistent with Commission demand response policy. Consistent with the Commission's policies, Enforcement previously provided to the Commission Lincoln's responses to staff's preliminary conclusions as part of Enforcement's memorandum regarding settlement authority.

## II. BACKGROUND

### A. Lincoln

Lincoln is a privately held limited liability company that owns and operates a paper mill in Lincoln, Maine. The Lincoln mill manufactures specialty paper, tissue and pulp products and is the largest producer of deep-dyed tissue in the United States.<sup>4</sup> When fully operational, the mill's electricity load is approximately 20 MW.<sup>5</sup> As the mill

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<sup>3</sup> Lincoln's response to Enforcement's § 1b.19 notice includes, among other documents: a narrative response to Enforcement's § 1b.19 notice (Lincoln § 1b.19 Response); three responses to Enforcement's preliminary conclusions letter dated November 24, 2009 (Lincoln's First Response), May 5, 2011 (Lincoln's Second Response), May 10, 2011 (Lincoln's Third Response); and Lincoln's July 11, 2011 letter to Enforcement responding to Enforcement's § 1b.19 notice.

<sup>4</sup> Lincoln Paper and Tissue, LLC website, Lincoln Paper and Tissue Products page, <http://www.lpandt.com/products/> (last visited January 17, 2012).

<sup>5</sup> Capacity Estimates Work Sheet; LINC000688 and LINC000730; *accord* Brennan Dep. 35:7-9, Dec. 16, 2008 (estimating facility load between 19 and 20 MW).

operates 24-hours a day in equal work shifts, the mill's load does not fluctuate appreciably between day and night hours.<sup>6</sup>

Lincoln meets its energy needs through on-site generation and power purchases from Constellation NewEnergy, Inc. (Constellation) in the spot market or as blocks of power.<sup>7</sup> Lincoln's physical plant includes three generators; two steam-powered turbine generators to generate electricity and a backup emergency diesel generator for the mill's waste treatment plant.<sup>8</sup> The two steam-powered generators are known as the "Westinghouse" and the "TG3."<sup>9</sup> The Westinghouse generator has a nameplate capacity of 4 MW and the TG3 has a capacity of 13 MW.<sup>10</sup>

Through December 2007, Lincoln usually operated the Westinghouse generator 24 hours a day, seven days per week, to meet the energy needs of the paper mill.<sup>11</sup> Lincoln began operational testing of the newer and more efficient TG3 generator in November 2007, which commenced commercial operations on January 15, 2008.<sup>12</sup> Since then, Lincoln infrequently operates the Westinghouse generator,<sup>13</sup> while TG3 operates 24 hours a day to meet Lincoln's demand.

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<sup>6</sup> Lincoln Data Response 16(a), Responses of Lincoln Paper and Tissue, LLC to April 7, 2008 Data Requests (Revised Sept. 26, 2008); *accord* Van Scotter Dep. 30:5-20, Dec. 15, 2008 and Brennan Dep. 37:13-20, Dec. 16, 2008.

<sup>7</sup> Van Scotter Dep. 37:21-24; 38:2-10; 119:11-15; *accord* Brennan Dep. 113:5-24.

<sup>8</sup> Lincoln Data Response 11(a)-(c); *accord* Van Scotter Dep. 37:11-15. The back-up emergency diesel generator has not been a factor in the investigation because it has only a 1 MW capacity and rarely operates. Lincoln Data Response 11(b); *accord* Van Scotter Dep. at 37:16-20; 45:2-15.

<sup>9</sup> Lincoln Data Response 11(a)-(c); *accord* Van Scotter Dep. 26:3-5.

<sup>10</sup> Lincoln Data Response 11(a)-(c); *accord* Van Scotter Dep. 37:11-16; *accord* Capacity Estimates Work Sheet; LINC000688 and LINC000730.

<sup>11</sup> Lincoln Response to FERC Data Request No. 16(b) at LINC000643 (spreadsheet showing planned and unplanned generation outages from April 1, 2006 through May 9, 2008); *accord* Van Scotter Dep. 46:17-19 and Brennan Dep. 145:4-21.

<sup>12</sup> Lincoln Data Response 11(c).

<sup>13</sup> Lincoln Data Response 11(a); *accord* Van Scotter Dep. 47:1-5.

## 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.”<sup>14</sup> Demand response programs require, at the least, either reduced consumption or increased production of electricity by the responder. 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.<sup>15</sup>

ISO-NE’s DALRP was implemented in June 2005 as a supplemental program to ISO-NE’s real-time load response programs.<sup>16</sup> The goal of all of ISO-NE’s load response

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<sup>14</sup> *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). The Commission has stated that, 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).

<sup>15</sup> Order No. 745 at P 8-9 (citing 16 U.S.C. § 824d (2006)).

<sup>16</sup> *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.

programs is to “reduc[e] peak electricity demand by large power users.”<sup>17</sup> 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 their electricity consumption in the New England Control Area during peak demand periods.”<sup>18</sup>

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.<sup>19</sup> Once an initial baseline was established, the baseline adjusted on a rolling basis using actual load data from the resource.<sup>20</sup>

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.<sup>21</sup> 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.<sup>22</sup> The participant’s real-time load was measured against its baseline to

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<sup>17</sup> ISO New England Load Response Program Manual at 1-1 (LRP Manual).

<sup>18</sup> ISO-NE Tariff, Appendix E to Market Rule 1, § III.E.1.1.

<sup>19</sup> LRP Manual, § 4.2.1.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*, § 4.2.2.

<sup>22</sup> *Id.*, § 4.5.1.1.

quantify the load reduction.<sup>23</sup> As an example, in a given hour if a resource's baseline was 90 MW and actual electrical consumption from the grid was 87 MW, the calculated load reduction was 3 MW.

During the period covered by Enforcement's investigation the minimum DALRP offer price was \$50.00 per MWh.<sup>24</sup> 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.<sup>25</sup> If resources reduced more in Real-Time than the amount cleared in the DALRP as measured against their customer baseline, they were paid 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.<sup>26</sup>

Demand response resources participated in the DALRP with assistance from third-parties known as Enrolling Participants.<sup>27</sup> The Enrolling Participant registered the resource in the DALRP 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.<sup>28</sup> Regarding Lincoln's participation, Constellation retained 15% of DALRP revenues as the Enrolling Participant and distributed 85% to Lincoln.<sup>29</sup>

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<sup>23</sup> *Id.*, § 4.3.1.3.

<sup>24</sup> 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).

<sup>25</sup> LRP Manual § 4.5.1.1.

<sup>26</sup> *Id.*, § 4.5.1.1.

<sup>27</sup> *Id.*, § 2.2.1.

<sup>28</sup> *Id.*, § 4.5.4.

<sup>29</sup> Constellation Data Response 64; CNE0023813-23818.

### III. STAFF'S FINDINGS AND ANALYSIS

#### A. Findings

##### **Lincoln's Senior Management Devised a Scheme for Lincoln's DALRP Participation**

In mid-2007, Constellation approached Lincoln about participating in the DALRP. Lincoln had successfully participated, by curtailing load, in ISO-NE's Demand Response Winter Supplemental Program from December 2005 through March 2006 with a different Enrolling Participant and was familiar with the concept of demand response.<sup>30</sup> In July 2007, Lincoln enrolled in ISO-NE's DALRP and 2-hour Real-Time Demand Response Program with Constellation as its Enrolling Participant.

Lincoln's senior management developed and implemented the scheme Lincoln employed to participate in and profit from the ISO-NE DALRP without help from Constellation or other outside advisors.<sup>31</sup> Lincoln's scheme for DALRP participation was to curtail the Westinghouse generator while the baseline was being established and increase Lincoln's purchases of electricity during the baseline period. The combination of curtailing generation and increasing power purchases would increase electricity consumption (or load), resulting in an inflated baseline. Once Lincoln began participating in the DALRP, Lincoln could operate its generator normally, yet appear to be reducing load relative to the inflated baseline. If Lincoln offered into the DALRP every day, and those offers cleared, then the baseline would remain static and would not change to reflect actual generation or the mill's energy usage. Lincoln could then be continually compensated for claimed load reductions against its artificially inflated baseline.

Keith Van Scotter, Lincoln's President and Chief Executive Officer (CEO), admitted that he and Michael Brennan (Lincoln's Purchasing and Logistics Manager), the Lincoln employee with primary responsibility for administering the DALRP, were the only two Lincoln employees who reviewed the LRP Manual.<sup>32</sup> Van Scotter also acknowledged that the decision to curtail generation during the baseline period was made by him, Brennan and Pat MacEachern, Manager of Utilities.<sup>33</sup> Lincoln's management

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<sup>30</sup> Lincoln Data Response 3 (describing how Lincoln proved its ability to respond to a demand response call during two audit events by shedding load); *accord* LINC000265-284; LINC000440-459.

<sup>31</sup> Van Scotter Dep. 39:18-19; 79:17 – 80:4.

<sup>32</sup> *Id.* at 79:17-22.

<sup>33</sup> *Id.* at 100:16 – 102:6.

never discussed this decision with Constellation and Constellation did not know how Lincoln had set its baseline.<sup>34</sup> During the initial baseline creation period in July 2007, and again in August 2007, during the beginning of its participation in the DALRP, Lincoln verified with Constellation that cleared daily offers into the DALRP would freeze the baseline.<sup>35</sup>

### **Lincoln's Senior Management Implemented this Scheme Without Notifying Constellation**

Lincoln's initial five-day baseline period ran from July 25, 2007, through July 31, 2007, (excluding July 28 and 29, 2007, which were non-business days). Consistent with the agreed upon scheme, Lincoln curtailed generation from the Westinghouse unit by approximately 3 MW,<sup>36</sup> during the DALRP program hours during the baseline period.<sup>37</sup> Other than the generator's curtailment, Lincoln operated as it otherwise would have absent DALRP participation.<sup>38</sup> Other than curtailing generation, Lincoln did not increase its load.<sup>39</sup> The curtailment resulted in an atypical load pattern for each of the baseline days with Lincoln's load increasing to approximately 19 MW just prior to 7:00 AM, continuing at that level until 6:00 PM, and dropping back to approximately 16 MW just after 6:00 PM.

Table 1<sup>40</sup> demonstrates the five-day load profile for Lincoln using this scheme, including the marked increase in electricity consumption during the hours measured to calculate the baseline.

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<sup>34</sup> Constellation Data Response 5, 12, 19-21, 25 and 27-28, Responses of Constellation NewEnergy, Inc. to April 7, 2008 Data Requests (May 9, 2008).

<sup>35</sup> See Email from Amy Richard, Manager, Energy Technology Services, Constellation NewEnergy, to Michael Brennan, Purchasing and Logistics Manager, Lincoln Paper and Tissue (July 27, 2007); Van Scotter Exh. No. 3; accord Brennan Exh. No. 4; see also Email from Glen Brickey, eLutions, to Pat MacEachern, Lincoln Paper and Tissue (August 17, 2007); Brennan Exh. No. 6.

<sup>36</sup> Capacity Estimates Work Sheet; LINC000688 and LINC000730; accord Brennan Dep. 35:7-9 and Brennan Dep. 112:7-20.

<sup>37</sup> Van Scotter Dep. 98:19-20;113:7-13.

<sup>38</sup> *Id.* at 98:9-99:9.

<sup>39</sup> *Id.* at 110:10-111:3.

<sup>40</sup> See December 7, 2011 ISO-NE Data Response.

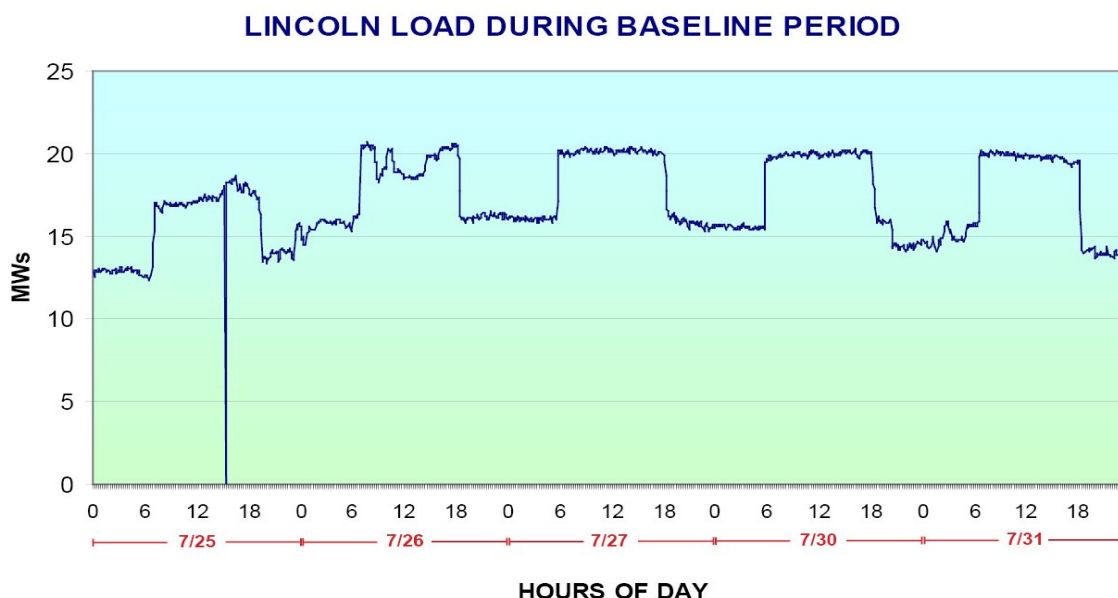


Table 1 demonstrates the increase in Lincoln's load during the five days relied upon by ISO-NE to establish Lincoln's baseline.<sup>41</sup> Just before 7:00 AM on each day, Lincoln curtailed generation from the Westinghouse unit and load dramatically spiked. This generation curtailment continued throughout the day until just after 6:00 PM, when ISO-NE stopped reviewing data to calculate the baseline.

Beginning on July 31, 2007,<sup>42</sup> through early February 2008, Lincoln submitted daily, non-holiday weekday load reduction offers for each program hour in the DALRP.<sup>43</sup> 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).<sup>44</sup> As LMP prices in ISO-NE were virtually always above \$50.00 during program hours, Lincoln's offers virtually always cleared the market and the company received DALRP revenues for each day. Lincoln's inflated baseline remained unchanged. As

<sup>41</sup> Note that Saturday July 28 and Sunday July 29 are excluded from the chart as weekend days are not used to calculate the baseline.

<sup>42</sup> Lincoln submitted its first offers for load reduction on July 31, 2007 for the next day. August 1, 2007 was Lincoln's first day of participation in the DALRP.

<sup>43</sup> See Lincoln DALRP Spreadsheet; Lincoln Data Response 14; LINC000511-16; also identified as Brennan Exh. No. 2 (containing data regarding Lincoln's offers into the DALRP, customer baseline, and DALRP revenue).

<sup>44</sup> *Id.*



ISO-NE compared Lincoln's actual load to its inflated baseline, it appeared that Lincoln was reducing load and was compensated at the relevant LMP. The only circumstances in which Lincoln's offers did not clear were when: (1) Lincoln inadvertently submitted an invalid offer or (2) Lincoln rescinded an offer due to downtime for the Westinghouse unit.

Once the inflated baseline had been established, Lincoln operated its paper mill and generation facilities the same way it had operated them before the baseline period.<sup>45</sup> Lincoln did not increase its generation to provide demand response. Likewise, Lincoln never reduced its electrical consumption as a consequence of its DALRP participation.<sup>46</sup> Lincoln never intended to modify its operations and both Van Scotter and Brennan admitted that Lincoln did not modify either its paper mill production schedule or generation schedules as a result of participating in the DALRP.<sup>47</sup> Moreover, Van Scotter admitted that Lincoln "would not purposely curtail an entire production line, like a paper machine or tissue machine, for a day-ahead load response event,"<sup>48</sup> nor were there other facilities that Lincoln would idle in order to participate in the DALRP.<sup>49</sup>

Lincoln had no written procedures in place regarding reduction of energy consumption on days when DALRP offers were accepted. By contrast, Lincoln created an "ISO Load Shedding Command Response Procedure" to ensure that Lincoln reduced load when called upon in the ISO-NE *Real-Time* demand response program.<sup>50</sup> This fact is consistent with Lincoln's expectation that it would not have to modify its operations to participate in and profit from the DALRP program. Lincoln's offers were communications to ISO-NE of an availability and willingness to reduce load by a specified amount at a specified price, yet Lincoln never intended to and never actually did reduce load when its offers cleared.<sup>51</sup>

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<sup>45</sup> Van Scotter 181:12-15; Brennan Dep. 182:23-183:21.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> Van Scotter Dep. 159:6-8.

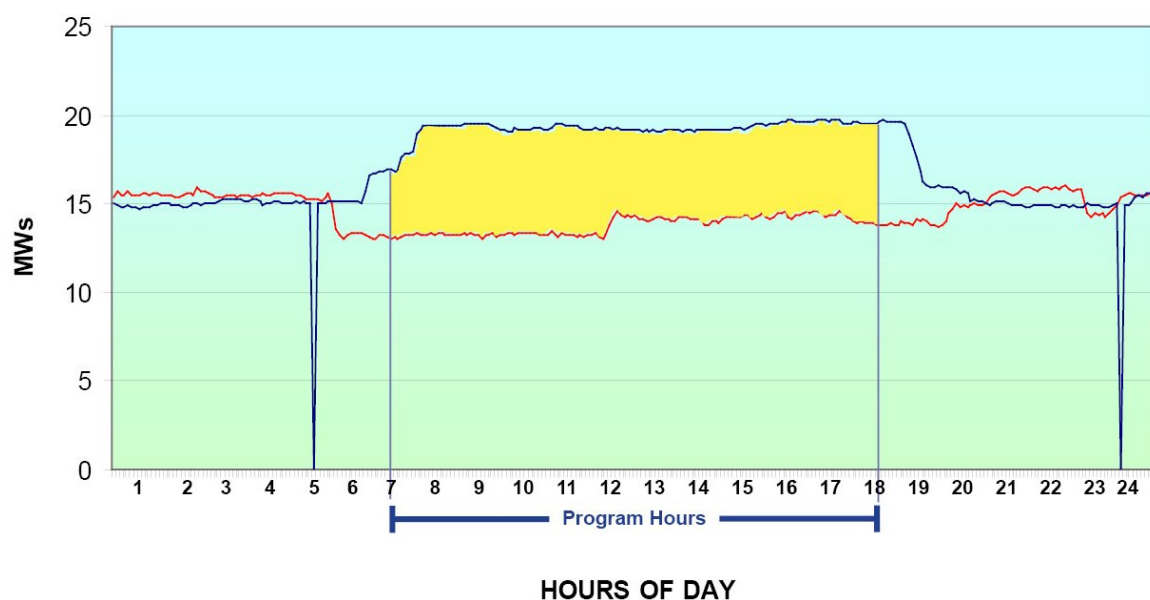
<sup>49</sup> *Id.* at 159:9-12.

<sup>50</sup> ISO Load Shedding Command Response Procedure; LINC000261-64.

<sup>51</sup> See Lincoln DALRP Spreadsheet; Lincoln Data Response 14; LINC000511-16; also identified as Brennan Exh. No. 2 (containing data regarding Lincoln's offers into the DALRP, customer baseline, and DALRP revenue).

Table 2<sup>52</sup> compares the baseline for Lincoln with Lincoln's actual load on August 1, 2007 (its first day offering into the DALRP). ISO-NE, unknowingly relying upon an inflated baseline, compared Lincoln's actual load against the baseline to calculate the amount of load purportedly "reduced" by Lincoln during the program hours (the shaded area). ISO-NE paid \$5,015.36 for Lincoln's phantom load response on August 1, 2007.<sup>53</sup>

### LINCOLN AUGUST 1, 2007 DALRP PARTICIPATION



A similar pattern is reflected for virtually every day of Lincoln's DALRP participation. As a result of the scheme, ISO-NE paid \$445,901.21 for demand response that never occurred. Of this amount, Lincoln received \$379,016.03.

## B. Analysis

### Lincoln 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.<sup>54</sup> 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,

<sup>52</sup> See December 7, 2011 ISO-NE Data Response.

<sup>53</sup> *Id.*

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.<sup>55</sup> Fraud is a “question of fact that is to be determined by all the circumstances of a case.”<sup>56</sup>

- 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, Lincoln’s actions constitute a fraudulent scheme or artifice. Lincoln’s scheme was based on misrepresentations to ISO-NE about Lincoln’s typical load and willingness and ability to reduce load. Because of these misrepresentations, Lincoln was compensated for load response that it knew would never occur and in fact never occurred.

By curtailing generation and buying more grid power, Lincoln knowingly established and communicated to ISO-NE an inflated baseline that did not reflect Lincoln’s genuine load response capability, as Lincoln did not intend to reduce its consumption or increase its generation once the baseline was established. The baseline is a critical component to determining the load reduction of load response resources and calculating load response payments. Additionally, by submitting daily offers to reduce load, Lincoln communicated a willingness and ability to reduce load. These communications were false because, as Lincoln understood, Lincoln was not reducing load and did not intend to reduce load as a result of its DALRP participation. Instead, Lincoln 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) Scienter

Lincoln knowingly adopted and participated in a scheme that established an inflated DALRP baseline. Lincoln knew it would be compensated for doing nothing, i.e.,

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<sup>54</sup> 16 U.S.C. §824v(a) (2006).

<sup>55</sup> 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).

<sup>56</sup> See *id.* at P 50.

that it would not actually reduce any load when it participated in the DALRP.<sup>57</sup> Instead, Lincoln would be paid for phantom load reductions without any appreciable change in the mill's operations. Lincoln understood that it would neither increase generation nor decrease electricity consumption as part of its participation. In sum, Lincoln knowingly participated in a scheme with the intent to defraud ISO-NE by getting DALRP payments to which it was not entitled.

While Lincoln's intent is clear, scienter is also satisfied through recklessness.<sup>58</sup> Recklessness has been defined as "conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care"<sup>59</sup> or "an extreme departure from the standards of ordinary care that presents a danger that is either known to the defendant or so obvious that the actor must have been aware of it."<sup>60</sup> Lincoln had previous experience with demand response programs and Lincoln's managers understood that demand response requires a change in a participant's consumption pattern. Legitimate actions to reduce load are the same regardless of the type of demand response program an entity is enrolled in. It does not matter whether the demand response program is for real-time or day-ahead. On two separate occasions, Lincoln prepared detailed written procedures instructing the mill to shed load for its participation in real-time demand response programs.<sup>61</sup> Yet, it chose to participate in the DALRP without any

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<sup>57</sup> Van Scotter Dep. 159:6-12; 181:12-15; Brennan Dep. 182:23-183:21.

<sup>58</sup> *Prohibition of Energy Market Manipulation*, Order No. 670, FERC Stats. & Regs. ¶ 31,202 (2006) at P 53.

<sup>59</sup> *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977); *Rolf v. Blyth, Eastmond, Fillon & Co.*, 570 F.2d 38 (2d Cir. 1978).

<sup>60</sup> *N.Y. Indep. Sys. Operator, Inc.*, 128 FERC ¶ 61,049 at 61,258 (2009). *See also Amaranth Advisors, L.L.C.*, 120 FERC ¶ 61,085 at P 112 (2007) (recklessness may be found if there is a danger "so obvious that the actor must have been aware of the danger").

<sup>61</sup> LINC000265-284; LINC000440-459 and LINC000261-264. The ISO Load Shedding Command Response Procedure issued on August 1, 2007 states: "Lincoln Paper and Tissue has enrolled in a demand response program through ISO New England. During times when the power grid is in danger of being short of power supply, the system operator for New England will call and ask customers to produce more power or shed electrical load. *By enrolling in the program [Lincoln] will be compensated for being able to shed load. We will also be compensated for the power that we don't use during an event.*" LINC000261 (emphasis added). Lincoln did not create any such procedures for the DALRP.

intention of increasing generation or decreasing electricity consumption as part of its participation. In these circumstances, recklessness is evident.<sup>62</sup>

For these reasons, Enforcement concludes that scienter 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."<sup>63</sup> 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 determine which practice that affect rates must be described in that rate schedule.<sup>64</sup> 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.<sup>65</sup>

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<sup>62</sup> See, e.g., *U.S. v. Draves*, 103 F.3d 1328, 1333 (7th Cir.), cert. denied, 521 U.S. 1127 (1997) ("knowledge may in some circumstances be inferred from strong suspicion of wrongdoing coupled with active indifference to the truth"); *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004) (recklessness may be found where subject encounters "suspicious events creating reasons for doubt" that should have alerted him to improper conduct); *Graham v. SEC*, 222 F.3d 994, 1006 (D.C. Cir. 2000).

<sup>63</sup> 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.

<sup>64</sup> *City of Cleveland v. FERC*, 773 F.2d 1368, 1376 (D.C. Cir. 1985). See also *Connecticut Dept. of Pub. Util. Control v. FERC*, 569 F.3d 477, 483-85 (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).

<sup>65</sup> See *Wholesale Competition in Regions with Organized Electric Markets*, Order No. 719, FERC Stats. & Regs. ¶ 31,281 (2008), *order on reh'g*, Order No. 719-A,

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.<sup>66</sup> Lincoln voluntarily participated in this jurisdictional program, provided misleading information to Constellation and ISO-NE regarding its participation, and profited directly from the fraud. Accordingly, staff concludes that Lincoln's fraudulent activity was in connection with a jurisdictional transaction and violated 18 C.F.R. § 1c.2.

### C. Defenses Raised by Lincoln

Lincoln does not dispute staff's key factual findings. Lincoln admits it decided to curtail generation from the Westinghouse unit during the baseline period and purchase additional power from Constellation. Lincoln also admits that it submitted daily DALRP offers through Constellation for the minimum price of \$50/MWh between August 2007 and February 2008 and that, as a result of these offers, Lincoln's baseline remained static. However, throughout Enforcement's investigation, Lincoln has submitted several *post hoc* justifications for its actions. While Lincoln's defenses have evolved over time, most of Lincoln's arguments can be condensed into a simple assertion: its behavior was appropriate.<sup>67</sup>

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74 Fed. Reg. 37,776 (Jul. 29, 2009), FERC Stats. & Regs. ¶ 31,292 (2009), *order on reh'g*, Order No. 719-B, 129 FERC ¶ 61,252 (2009).

<sup>66</sup> 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).

<sup>67</sup> Lincoln makes one argument unrelated to the merits of its participation in the DALRP. Lincoln complains that Enforcement's § 1b.19 notice was deficient because it did not specifically discuss Lincoln's defenses and served to "prevent the Commission from hearing a full and open debate about the case through the § 1b.19 process, and [] deprive Lincoln of a meaningful opportunity to engage the merits of Enforcement Staff's arguments." Lincoln § 1b.19 Response at 1-2. Lincoln's allegations are patently false and irrelevant to whether Lincoln violated § 1c.2 of the Commission's regulations. Section 1b.19 does not require that Enforcement's § 1b.19 notice include a detailed point-by-point analysis of Lincoln's defenses. Moreover, while Lincoln claims to be unaware

Enforcement has reviewed all of Lincoln's arguments and finds them to be without merit. Lincoln makes various arguments, that essentially fall within six categories discussed below.

**Lincoln's *Post Hoc* Rationalizations Regarding the Existence of the Fraudulent Scheme and Lincoln's Intent**

1. Lincoln's *post hoc* claim that its decision to curtail the Westinghouse unit during the baseline was principled and appropriate

Lincoln claims that it set its initial baseline by ramping down the Westinghouse unit by approximately 3 MW, to an output level of 1 MW, and that it did so in order to reflect a "normal operating state" that took into account the fragile characteristics of the Westinghouse unit and its uncertain future while still providing steam for mill operations.<sup>68</sup> Staff disagrees with Lincoln's claim that it had a legitimate purpose for curtailing the Westinghouse unit during the initial baseline period because having the mill curtailed was more reflective of "normal" operations. First, Lincoln never produced any contemporaneous documents relating to the establishment of its baseline. Only Lincoln's narrative responses to Enforcement and the testimony of Van Scotter support this defense.<sup>69</sup> Second, while Van Scotter claimed that the Westinghouse unit was curtailed during the baseline period because "given the age and condition of the unit and its declining reliability, [Lincoln] thought that having it curtailed some was more representative of normal operations,"<sup>70</sup> this claim is inconsistent with other evidence.

Lincoln's data showed that from April 2006 through July 2007 (the beginning of Lincoln's participation in the DALRP), the Westinghouse generator experienced only five outages that were not related to mill downtime or a scheduled overhaul and repair in

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of staff's arguments regarding Lincoln's defenses, staff has repeatedly explained its positions to Lincoln. Lincoln will have additional opportunities to provide defenses and arguments in response to an order to show cause should the Commission agree with this Report's recommendation, and again in a determination of the merits should the matter proceed to trial-type resolution. Lincoln's alleged due process arguments are unfounded.

<sup>68</sup> Lincoln § 1b.19 Response at 3, citing Van Scotter Dep. at 100:17-18; 47:1-17.

<sup>69</sup> Michael Brennan, who had primary responsibility for administering the DALRP program, never made this claim in his testimony.

<sup>70</sup> Van Scotter Dep. at 100:17-20.

December 2006.<sup>71</sup> Once Lincoln began participating in the DALRP, the Westinghouse generator was out of service only three times from July 2007 through December 2007<sup>72</sup> for less than six hours each time.<sup>73</sup> Only five unplanned outages prior to enrolling in DALRP does not justify the curtailment of the Westinghouse unit during the baseline creation to mimic “normal” operations.

Assuming that Lincoln wished to establish a baseline that was reflective of “normal” operations, Lincoln failed to account for the new TG3 generator either when it established its customer baseline or when the TG3 had fully replaced the Westinghouse unit.<sup>74</sup> Replacing the 4 MW Westinghouse unit with the 13 MW TG3 unit created a new normal for the mill. In the fall of 2007, Lincoln told Constellation that it intended to start the new TG3 unit in December 2007 or January 2008.<sup>75</sup> However, when Constellation later advised Lincoln via email that baseload assets such as the Westinghouse or TG3 must be accounted for in the baseline,<sup>76</sup> Lincoln failed to respond to the email, or to follow-up emails and phone calls from Constellation to discuss the issue.<sup>77</sup>

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<sup>71</sup> See Lincoln Response to FERC Data Request No. 16(b), LINC000643-668. This spreadsheet states that “The Westinghouse turbine generator (Westinghouse TG) was scheduled to operate 24 hours per day, 7 days per week except for mill downtime (yellow) and an overhaul and repair in December 2006 that is shaded orange.” LINC000643. The spreadsheet also notes that the Westinghouse unit was idled when the TG3 unit commenced operation. *Id.*

<sup>72</sup> The Westinghouse generator was idled on December 18, 2007 when the new TG3 unit commenced operations. See LINC000662.

<sup>73</sup> Lincoln Data Response 16(b) (citing LINC000643-668). Van Scotter was also unable to identify a specific instance when maintenance issues triggered curtailment of the Westinghouse turbine between July 2007 through the start up of the new TG3 unit in January 2008. Van Scotter Dep. 107:16-22.

<sup>74</sup> Lincoln knew that the new generator would be coming on line when it set its baseline in July 2007, because the project to install the new generator began in the fourth quarter of 2005. See Lincoln Response at 4.

<sup>75</sup> Brennan Dep. 145:22-146:14.

<sup>76</sup> Email from Brett Feldman, Program Manager, Sustainable Energy Solutions, Constellation NewEnergy to Michael Brennan, Purchasing and Logistics Manager, Lincoln Paper and Tissue (November 29, 2007); LINC000025; Brennan Exh. No. 7.

<sup>77</sup> Email from Brett Feldman, Program Manager, Sustainable Energy Solutions, Constellation NewEnergy to Christopher Begin, Business Development



Fraudulent purpose, not operational necessity, governed Lincoln's participation in the DALRP. Lincoln's decision not to adjust its baseline to account for the new TG3 unit produced significant unjust profits. From August 2007 through November 2007, Lincoln's monthly DALRP revenues ranged from \$43,514.82 to \$51,390.34.<sup>78</sup> In December 2007, Lincoln's DALRP payment shot up to \$83,162.27 because the TG3 generator produced substantially more electricity and reduced the amount of electricity Lincoln purchased from Constellation.<sup>79</sup> From ISO-NE's perspective, not knowing of the new generator, this was evidence that Lincoln was further reducing load. Lincoln's compensation increased again in January 2008, when it received \$91,120.76 in DALRP payments.<sup>80</sup> The sudden increase in Lincoln's DALRP compensation upon the introduction of the TG3 generator was predictable. Lincoln replaced a 4 MW generator with a 13 MW generator and failed to account for a significant increase in behind the meter generation. Even though the mill's "normal" operations had clearly changed, Lincoln made no effort to ensure that its baseline reflected that change.

Lincoln's claim that it had a legitimate purpose for curtailing the Westinghouse unit during the initial baseline period because having the mill curtailed was more reflective of "normal" operations does not withstand scrutiny. Instead, the factual record demonstrates that Lincoln intended to curtail generation during the baseline period to establish an inflated baseline and obtain payments for load response when it did not intend to reduce load.

## 2. Lincoln claims its behavior benefitted consumers

ISO-NE Network Load (i.e., most consumers of energy in New England) paid almost half a million dollars for Lincoln's phantom demand response. Despite this fact,

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Manager, Constellation NewEnergy and Peter Kelly-Detwiler, Senior Vice President for Energy Technology Services, Constellation NewEnergy (January 28, 2008) ("Below you can see what I sent Mike Brennan 3 times with no reply, and he has not returned phone calls either"); *accord* Brennan Ex. No. 8 (including only the correspondence between Brett Feldman and Michael Brennan from November 29, 2007 through January 11, 2008). Lincoln did not provide this latter email chain. Staff discovered Constellation's subsequent emails in Constellation's data responses. *See* CNE0000237-239.

<sup>78</sup> Constellation Supplemental Response to FERC Data Request No. 64 at CNE0023813 (spreadsheet showing DALRP payments to Lincoln, Lincoln, Constellation and CES from August 2007 through June 2008).

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

Lincoln argues that its “demand response created net benefits.”<sup>81</sup> To support this proposition, Lincoln submitted an affidavit from economist Dr. Ray Shanker.<sup>82</sup> Enforcement disagrees with this analysis as it assumes, incorrectly, that Lincoln provided legitimate demand response. As discussed above, all of Lincoln’s claimed demand response was the result of an inflated baseline scheme. Since Lincoln did not reduce load to participate in the DALRP and was effectively paid for “doing nothing,” Lincoln’s participation provided no benefit to consumers.

### **Lincoln Blames Other Entities and Demand Response Rules**

#### **3. Lincoln blames ISO-NE and Constellation**

Lincoln has claimed that its behavior was excused by, or was the result of, other entities’ behavior. For example, Lincoln claims it was entitled to assume that if there were aspects of setting a baseline that raised particular risks or concerns, then either Constellation or ISO-NE would have explained the issues to Lincoln and helped to find a solution.<sup>83</sup> In particular, Lincoln, citing the LRP Manual, asserts that Constellation was responsible for “signing up, setting up, and training customers and assisting them in develop[ing] load curtailment strategies.”<sup>84</sup> Lincoln does not attempt to explain why Constellation’s alleged failure to meet the LRP Manual’s obligations is a defense for Lincoln’s fraud under 18 C.F.R. § 1c.2.

Lincoln also states that it “concealed nothing about its baseline measurement from Constellation, which processed the same metering data that Enforcement Staff now depicts as evidence of manipulation.”<sup>85</sup> That is incorrect. There is no evidence that Lincoln told Constellation it had withheld generation during the baseline period. During the fall of 2007, Lincoln advised Constellation that it would be starting the new TG3 unit in December 2007 or January 2008 depending on testing.<sup>86</sup> In preparation for starting up the new generator, Lincoln asked Constellation a general question about distributed generation assets and participation in load response programs. In response, on November 29, 2007, Constellation sent Brennan an email advising Lincoln that baseload assets such

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<sup>81</sup> Lincoln § 1b.19 Response at 8.

<sup>82</sup> Lincoln’s Second Response, Attachment A.

<sup>83</sup> Lincoln’s Second Response at 5.

<sup>84</sup> Lincoln’s First Response at 6.

<sup>85</sup> Lincoln’s Second Response at 5.

<sup>86</sup> Brennan Dep. 145:22-146:14.

as the Westinghouse or TG3 must be accounted for and expressed concern that “the baseline for the Demand Response asset should reflect the reduction of load drawn from the grid due to the use of the Distributed Generation asset.”<sup>87</sup> Lincoln never responded to this email<sup>88</sup> or to Constellation’s follow-up emails on December 7, 2007, and January 11, 2008.<sup>89</sup> Lincoln ignored Constellation’s concerns, continued to submit offers to reduce load from these generators into the DALRP after receiving these emails,<sup>90</sup> and did not adjust its baseline once the TG3 unit commenced operations.<sup>91</sup>

Moreover, staff’s investigation revealed no evidence that Lincoln actually relied on Constellation or ISO-NE to evaluate Lincoln’s DALRP participation and Lincoln cites none. Lincoln could have contacted Constellation or ISO-NE regarding the legitimacy of its scheme, but it chose not to do so. Lincoln cannot blame Constellation or ISO-NE for its own fraudulent behavior.

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<sup>87</sup> Email from Brett Feldman, Program Manager, Sustainable Energy Solutions, Constellation NewEnergy to Michael Brennan, Purchasing and Logistics Manager, Lincoln Paper and Tissue (November 29, 2007); LINC000025; Brennan Exh. No. 7.

<sup>88</sup> Brennan Dep. 156:24-157:5.

<sup>89</sup> Email from Brett Feldman, Program Manager, Sustainable Energy Solutions, Constellation NewEnergy to Christopher Begin, Business Development Manager, Constellation NewEnergy and Peter Kelly-Detwiler, Senior Vice President for Energy Technology Services, Constellation NewEnergy (January 28, 2008) (“Below you can see what I sent Mike Brennan 3 times with no reply, and he has not returned phone calls either”); *accord* Brennan Ex. No. 8 (including only the correspondence between Brett Feldman and Michael Brennan from November 29, 2007 through January 11, 2008). *See* CNE0000237-239.

<sup>90</sup> Lincoln DALRP Spreadsheet; Lincoln Data Response 14; LINC000511-16; also identified as Brennan Exhibit No. 2 (containing data regarding Lincoln’s offers into the DALRP, customer baseline, and DALRP revenue).

<sup>91</sup> Brennan Dep. 159:7-11; 160:16-19 (“To the best of your knowledge has Lincoln ever readjusted its baseline as a consequence of the construction of the new 13.5 megawatt unit? I would say we have not changed.”); *accord* Lincoln DALRP Spreadsheet; Lincoln Data Response 14; LINC000511-16; also identified as Brennan Exh. No. 2 (containing data regarding Lincoln’s offers into the DALRP, customer baseline, and DALRP revenue).

#### 4. Lincoln blames “flaws” in DALRP rules

Lincoln also blames ISO-NE for adopting flawed DALRP rules. Lincoln argues that the DALRP program rules were flawed and that punishment of Lincoln is unwarranted as any improper Lincoln actions were a result of vague program rules.<sup>92</sup> Lincoln cites *Northwest Pipeline Corp.*, 109 FERC ¶ 61,356 at P 7, 9 (2004) and *Tres Palacio Gas Storage LLC*, 126 FERC ¶ 61,167 at P 11 (2009) for the general proposition that tariff provisions need to provide reasonable certainty.<sup>93</sup> Lincoln also points to statements from then Commissioners Kelly and Wellinghoff to the effect that more accurate and precise baseline methodologies are needed.<sup>94</sup> Lincoln goes on to cite the Commission’s 2008 Report on Enforcement<sup>95</sup> and a statement from then Chairman Kelliher on Enforcement Policy<sup>96</sup> for the proposition that civil penalties should not be imposed for purported violations of ambiguous requirements.<sup>97</sup> Lincoln also argues that its static baseline was the result of the ISO-NE tariff’s minimum offer being set at a floor of \$50.00 per MWh and that the market price of electricity was always over \$50.00 during Lincoln’s DALRP participation.<sup>98</sup> Lincoln states that it did not have any control over ISO-NE’s tariff or electricity market prices. Finally, Lincoln claims that Enforcement fails to consider the possibility that on-site generation resources may provide demand response.<sup>99</sup>

Lincoln’s arguments are misplaced. The evidence demonstrates that Lincoln decided upon and implemented a scheme to mislead ISO-NE and to obtain revenues for phantom load reductions. At the very least, the evidence demonstrates that Lincoln acted recklessly by engaging in the fraud. High energy prices did not cause Lincoln’s behavior. Rather, Lincoln used high energy prices in New England as an opportunity to implement

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<sup>92</sup> Lincoln Response at 8-11.

<sup>93</sup> *Id.* at 9.

<sup>94</sup> *Id.* (citing *ISO New England, Inc.*, 123 FERC ¶ 61,021 (2008) (Commissioner Kelly in concurrence and Commissioner Wellinghoff in dissent).

<sup>95</sup> 2008 Report on Enforcement, Docket No. AD07-13-001.

<sup>96</sup> Statement on Enforcement Policy from Chairman Joseph T. Kelliher, November 14, 2007, Docket No. AD07-13-000.

<sup>97</sup> Lincoln Response at 10.

<sup>98</sup> *Id.* at 11.

<sup>99</sup> *Id.* at 12.

a scheme to receive demand response payments without providing any load reductions. Lincoln decided to curtail its generation during the baseline period and to offer energy into the market every day to ensure that its baseline did not change. While ISO-NE's tariff did not explicitly prohibit such actions, tariffs cannot explicitly prohibit all fraudulent actions that market participants may undertake.<sup>100</sup> Indeed, § 1c of the Commission's regulations exists to prohibit market participants from engaging in such fraud.

Further, the evidence demonstrates that Lincoln's actions did not arise from ambiguity in the tariff or confusion as to the requirements of the DALRP.<sup>101</sup> When questioned by Constellation about how it had set its baseline<sup>102</sup> and when confronted with Constellation's concerns about hypothetical schemes identical to Lincoln's scheme,<sup>103</sup> far

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<sup>100</sup> For example, Lincoln asserts that its decision to submit DALRP offers at the minimum offer price of \$50.00 per MWh was permitted by the ISO-NE tariff. The company argues that it should not be penalized because "the energy market did not perform as anticipated by the designers of the DALRP." Lincoln Response at 11. Staff does not allege that Lincoln's offers, in isolation, violated § 1c.2. Rather, Lincoln's fraudulent scheme consisted of coupling minimum price offers with a fraudulently inflated baseline. The scheme, in its entirety, was fraudulent because it misrepresented Lincoln's load and resulted in payments for phantom load reductions.

<sup>101</sup> Lincoln often conflates violations of ISO-NE's tariff and manuals with violations of § 1c. *See, e.g.*, Lincoln Response at 6 ("Lincoln Followed the DALRP Program Manual"). The standards applicable to § 1c are different from tariff and manual violations. A market participant may not violate specific tariff/manual requirements, and yet commit fraud and violate § 1c. *See* Order No. 670 at P 25.

<sup>102</sup> Email from Brett Feldman, Program Manager, Sustainable Energy Solutions, Constellation NewEnergy to Christopher Begin, Business Development Manager, Constellation NewEnergy and Peter Kelly-Detwiler, Senior Vice President for Energy Technology Services, Constellation NewEnergy (January 28, 2008) ("Below you can see what I sent Mike Brennan 3 times with no reply, and he has not returned phone calls either"); *accord* Brennan Ex. No. 8 (including only the correspondence between Brett Feldman and Michael Brennan from November 29, 2007 through January 11, 2008). *See* CNE0000237-239.

<sup>103</sup> *See* Letter from Peter Kelly-Detwiler, Senior Vice President for Energy Technology Services, Constellation NewEnergy to Michael Brennan, Purchasing and Logistics Manager, Lincoln Paper and Tissue (January 23, 2008); LINC000236-37; also identified as Brennan Exh. 11.

from claiming confusion or asking for clarification or assistance, Lincoln's senior management essentially ignored Constellation.<sup>104</sup>

5. Lincoln generally claims that the complexity of demand response baselines excuses its behavior

Lincoln appears to blame the nature of demand response programs, generally, for its behavior. Arguing that it should not be held liable for creating a fraudulent baseline, Lincoln emphasizes a 2008 ISO-NE tariff filing explaining that some baseline methodologies for demand response programs are complex.<sup>105</sup> Because of this alleged complexity, Lincoln appears to claim that its actions cannot be deemed fraudulent.

Lincoln misstates the complexity of the DALRP and the scheme it adopted. 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 Lincoln misunderstood the baseline calculation process. In fact, Lincoln's clear understanding of the baseline process allowed it to adopt a scheme that it knew would be very profitable despite the fact that the company would be paid for doing nothing.

Second, not only was the DALRP baseline process understood by Lincoln, but the scheme was also simple: reduce generation when ISO-NE measure 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. Lincoln managers understood this scheme from the beginning. After Lincoln's first day of participating in the DALRP, Constellation staff emailed Brennan a summary of Lincoln's cleared day-ahead offers and informed Lincoln that it would receive \$3,754.076 net revenue from its first day in the DALRP.<sup>106</sup> Brennan forwarded

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<sup>104</sup> Brennan shared Constellation's letter with other Lincoln employees, including CEO Keith Van Scotter, Utilities Manager Pat MacEachern and the Executive Vice President and Mill Manager, Douglas Walsh. Brennan Dep. 167:14-20. After reviewing the letter, Keith Van Scotter's response was "continue in the program." *Id.* at 167:14-168:12. No Lincoln employee followed up with Constellation or otherwise inquired whether Lincoln was in compliance with the program's rules. Van Scotter Dep. 143:18-144:19; *accord* Brennan Dep. 168:13-169:9.

<sup>105</sup> Lincoln § 1b.19 Response at 4 (quoting *ISO New England, Inc.*, 123 FERC ¶ 61,021 at P 29 (2008)).

<sup>106</sup> See Email from Amy Richard, Manager, Energy Technology Services, Constellation NewEnergy, to Michael Brennan, Purchasing and Logistics Manager, Lincoln Paper and Tissue (July 31, 2007); Van Scotter Exh. No. 5.

this email to his colleagues, who responded enthusiastically.<sup>107</sup> In this exchange, Van Scotter stated that he would like to see lower energy prices, but not too low: “we want the price to be \$50, so our bid clears . . . This is good . . .”<sup>108</sup> Lincoln’s conduct was not the result of confusion or mistake; it was deliberate, calculated fraud.

### **Lincoln’s Interpretation of Order No. 745**

#### 6. Lincoln claims that Order No. 745 absolves Lincoln of its behavior

In its May 5, 2011 supplemental response to Enforcement’s preliminary conclusions letter, Lincoln argued for the first time that the company’s 2007-2008 behavior is consistent with the Commission’s order on compensation for demand response resources (Order No. 745) issued in 2011.<sup>109</sup> Lincoln claims that it could appropriately “set” the demand response baseline to be compensated for all on-site generation. Or, as Lincoln’s newly retained expert argues, “every MWh that Lincoln generates results in a MWh less of load on ISO-NE’s grid.”<sup>110</sup> Lincoln even argues that it implemented its scheme with restraint, and that it would have been “justified in turning its generator totally off when the baseline was being set”<sup>111</sup> resulting in an even more inflated baseline. Under Lincoln’s theory, Order No. 745 indicates that any participant with on-site generation could have enrolled in the DALRP and legitimately received payment for every MW of generation whether or not such generation would have occurred in the absence of the DALRP. Lincoln further argues that the matter of how to operate during baseline periods is unsettled in demand response programs nationwide: “There was, and is, not any ‘right’ or ‘wrong’ way to set baselines, particularly for a behind-the-meter generator like Lincoln, and particularly for a [demand response] market design like the DALRP.”<sup>112</sup>

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<sup>107</sup> See Email from Michael Brennan, Purchasing and Logistics Manager, Lincoln Paper and Tissue to Keith Van Scotter, John Wissman, Doug Walsh, Marco L’Italien and Bill Vallance (July 31, 2007); Van Scotter Exh. No. 5.

<sup>108</sup> See Email from Keith Van Scotter to John Wissman, Mike Brennan, Doug Walsh, Marco L’Italien and Bill Vallance (July 31, 2007); Van Scotter Exh. No. 5.

<sup>109</sup> Lincoln’s Second Response *passim*.

<sup>110</sup> *Id.* at 6.

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* at 4-5.

Lincoln's argument about Order No. 745 is untenable as a matter of fact, law, and common sense. First, Order No. 745 is simply irrelevant to Lincoln's behavior. Order No. 745 was issued in 2011, more than three years following the conclusion of Lincoln's fraud. Further, Order No. 745 addresses the amount that ISOs and RTOs will pay demand response resources. The order does not address the manner in which programs are administered, how baselines are calculated, or what constitutes fraud in demand response programs.<sup>113</sup> The order does not condone behavior that creates an inflated baseline or that allows demand response participants to be paid for demand response that does not occur. In fact, the Commission made clear that the opposite was true, stating that "[w]e agree with ISO-NE [Independent Market Monitor] that demand reductions that are not genuine may be violations of the Commission's anti-manipulation rules."<sup>114</sup>

Second, neither Order No. 745 nor any other Commission order or policy permits participation in demand response programs without reducing demand. As Lincoln knew, the purpose of demand response is to reduce energy consumption from the grid. However, the essence of Lincoln's *post hoc* argument is that it was permissible for Lincoln to be paid without actually reducing load. In fact, the only change in load caused by Lincoln's participation was an *increase* in load during the baseline period by Lincoln's purchase of \$10,000 of uneconomic replacement power. Order No. 745 does not permit (retroactively or prospectively) such fraud.

Third, even if Order No. 745 were somehow relevant, Lincoln ignores the facts surrounding its participation. There is no contemporaneous evidence that Lincoln relied upon the theory of participation that it claims was adopted in Order No. 745. There is no evidence that Lincoln believed that the DALRP compensated all generators for every MWh of production. Lincoln did not reduce output from the generator to zero during the baseline period, as Lincoln's *post hoc* rationalization suggests it should have done.

#### IV. SANCTIONS

##### A. Civil Penalty

###### Seriousness Factors

Lincoln'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.

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<sup>113</sup> Order No. 745 at P 94.

<sup>114</sup> *Id.* at P 95 (citing 18 C.F.R. Part 1c).



The following findings relating to the seriousness of Lincoln's violation guide staff's application of the Chapter Two guideline:

- Lincoln's violation resulted in a loss of \$445,901.21 to electricity customers in New England (i.e., the amount paid by Network Load for Lincoln's phantom load response).
- Lincoln'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 Lincoln's culpability and guide application of the Penalty Guidelines to derive a culpability score:

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

Regarding the compliance program factor, Lincoln has no chief compliance officer or similar individual specifically tasked with ensuring that the company complies with regulatory requirements.<sup>115</sup> Lincoln provided no training or formal written guidance to personnel responsible for managing Lincoln's participation in the DALRP aside from Constellation sales materials and ISO-NE manuals. Management made no effort to provide employees tasked with DALRP participation with specific energy compliance policies.

Staff recommends a civil penalty of \$4,400,000 for Lincoln. Lincoln's behavior is particularly problematic because senior managers orchestrated and implemented Lincoln's fraudulent scheme. Moreover, the individuals and entities harmed by Lincoln'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

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<sup>115</sup> Van Scotter Dep. at 182:9-18.

these circumstances, Enforcement believes that a civil penalty of \$4,400,000 within the Penalty Guidelines' range is appropriate.

### **B. Disgorgement**

The entirety of Lincoln's DALRP-related revenue from July 2007 through February 2008 was fraudulently obtained. Consequently, Lincoln should disgorge \$379,016.03 in unjust profits, plus interest under § 35.19(a) of the Commission's regulations.

### **C. Lincoln's Arguments Regarding Sanctions**

Lincoln argues that the Penalty Guidelines range results in "numbers [that] are beyond any rational bound of reasonable enforcement sanction" given the facts of this matter.<sup>116</sup> Enforcement disagrees based upon the foregoing discussion and the facts uncovered during its investigation.

Lincoln also argues that Enforcement's penalty calculation under Penalty Guideline is incorrect for three main reasons: (1) there was no market harm caused by Lincoln's behavior;<sup>117</sup> (2) there is "no transparency problem";<sup>118</sup> and (3) even the lowest possible penalty and disgorgement amount within the Penalty Guidelines range would "financially ruin" Lincoln.<sup>119</sup> Enforcement disagrees as: (1) Lincoln's fraud resulted in consumers paying over \$445,901.21 for phantom load response; (2) the penalty is not based upon an adder for lack of transparency; and (3) Lincoln's financial information contradicts this claim.<sup>120</sup>

## **V. RECOMMENDED ACTION**

Based on the above, Enforcement recommends the Commission issue Lincoln an Order to Show Cause why it did not violate 18 C.F.R. § 1c.2 (2011) in connection with Lincoln's fraudulent participation in the DALRP, and why the Commission should not require Lincoln to pay a civil penalty of \$4,400,000, disgorge \$379,016.03 plus interest, and adopt a plan to ensure future compliance. Enforcement also recommends the

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<sup>116</sup> Lincoln § 1b.19 Response at 10.

<sup>117</sup> Lincoln's Second Response at 26.

<sup>118</sup> *Id.*

<sup>119</sup> Lincoln § 1b.19 Response at 10.

<sup>120</sup> *See* LINCOLN-20110228-0299-301.

Commission make this Report public pursuant to 18 C.F.R. § 1b.20, and afford Lincoln the opportunity to respond to staff's findings.

In accordance with 18 C.F.R. § 385.213 (2011), Enforcement recommends the Commission direct:

- (a) Lincoln, 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 Lincoln's participation in ISO-NE's DALRP.
- (b) Lincoln, 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 \$4,400,000, 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 Lincoln's response, be required to file an answer to Lincoln's answer.

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Lincoln Paper and Tissue, LLC

Docket No. IN12-10-000

(Issued July 17, 2012)

LaFLEUR, Commissioner, *concurring*:

I join the majority in directing Lincoln 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*,<sup>1</sup> issued concurrently with this order, I believe that the majority's application of the Penalty Guidelines<sup>2</sup> in this case double counts the duration of Lincoln's alleged fraud. First, the Guidelines increase Lincoln's 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 Lincoln's 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 \$910,000-\$1,820,000, and proposed a civil penalty from within this corrected range.

Accordingly, I respectfully concur.

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Cheryl A. LaFleur  
Commissioner

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<sup>1</sup> *Rumford Paper Company*, 140 FERC ¶ 61,030 (2012).

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

Document Content(s)

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