

140 FERC ¶ 61,030
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.

Rumford Paper Company

Docket No. IN12-11-000

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 Rumford Paper Company (Rumford 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 \$13,250,000, or a modification of that amount consistent with section 31(d)(4) of the FPA, and disgorge \$2,836,419.08 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 Rumford (which operates a lumber mill in Maine) implemented a fraudulent scheme in connection with Rumford's participation in ISO-NE's DALRP. Specifically, OE staff alleges that another company, Competitive Energy Services, LLC (CES) advised Rumford to implement 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 Rumford developed this scheme, curtailing generation during the baseline period, intentionally creating a misleading baseline. Further, OE staff alleges that Rumford offered load response on a daily basis, fraudulently communicating a willingness and ability to reduce load. The OE Staff Report alleges that Rumford understood that it 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), 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 Rumford'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 \$13,250,000, or a modification of that amount consistent with section 31(d)(4) of the FPA, and require it to disgorge \$2,836,419.08 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*.

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: Rumford Paper Company



FEDERAL ENERGY REGULATORY COMMISSION

Rumford Paper Company

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 Rumford Paper Company (Rumford) in connection with Rumford'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 Rumford requiring it to show cause why it did not violate § 1c.2 of the Commission's regulations in connection with Rumford's participation in ISO-NE's DALRP, should not pay a civil penalty in the amount of \$13,250,000, and should not disgorge \$2,836,419.08 in unjust profits (all payments received as a result of participation in ISO-NE's DALRP).

Rumford adopted and implemented a scheme to defraud ISO-NE of demand response payments proposed by an energy consultant, Competitive Energy Services, LLC (CES) and CES's Managing Member, Dr. Richard Silkman (Silkman). Specifically, Rumford curtailed its 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), Rumford and CES decided to purchase replacement energy during the baseline period at a \$120,000 cost. By purchasing energy, instead of producing it on site, Rumford and CES 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 its baseline load and its normal operations) without actually reducing any load. For over six months in 2007 to 2008, Rumford engaged in a scheme that ensured the baseline never appreciably changed. Because of Rumford's behavior, electricity consumers in New England paid \$3,336,964.63 for

¹ 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.*, RUMF000029) and transcript references refer to the last name of the deponent, page, and line of the relevant transcript (*e.g.*, Guay Dep. 30:5-10). All cited documents and transcripts are available for Commission review.

demand response that never occurred. Of this amount, Rumford received \$2,836,419.08 in revenues.²

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

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

II. BACKGROUND

A. Rumford

Rumford owns and operates a large lumber mill in Rumford, Maine and produces a wide variety of paper products. During the time frame covered by the investigation, the mill's electricity load was generally 95 MW when fully operational. As the mill operated 24-hours a day in equal work shifts, the mill's load did not fluctuate appreciably between day and night hours. An on-site generator (referred to as "G4") with a nameplate capacity of 110 MW was operated to meet virtually all of Rumford's electricity needs,

² See Constellation0023813. Rumford received these profits during its July 31, 2007 through February 6, 2008 DALRP participation.

³ Rumford's response to Enforcement's 1b.19 notice includes, among other documents: a narrative response to Enforcement's 1b.19 notice (Rumford 1b.19 Response); Rumford's January 4, 2010 response to Enforcement's preliminary conclusions letter; five supplemental responses to Enforcement's preliminary conclusions letter; and a letter from Rumford to Enforcement dated July 11, 2011 responding to Enforcement's 1b.19 notice.

with Rumford purchasing additional or selling excess energy as necessary.⁴ When generating, G4 also produced steam which Rumford used as part of its paper manufacturing process.

Rumford is a subsidiary of NewPage Corporation, one of the largest manufacturers of paper products in North America. On September 7, 2011, NewPage and its affiliates, including Rumford, voluntarily filed to restructure its finances under Chapter 11 of the United States Bankruptcy Code in Delaware Federal District Court. NewPage anticipates an orderly restructuring of its debt and “expects that the Chapter 11 process will allow it to continue operating its U.S. operations [including Rumford] as usual.”⁵

B. CES, Dr. Richard Silkman, and Constellation

CES is an independent energy services company based in Portland, Maine. Beginning in 2003, CES has provided consulting services to Rumford regarding several energy-related initiatives. As a result, in 2007, CES and Silkman were very familiar with Rumford’s physical plant and energy use.

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 load response participants to Constellation, and Constellation enrolled the customers in ISO-NE’s demand response programs. Constellation compensated CES for the referrals based upon a percentage of the customer’s load response revenues. As discussed below, through this arrangement CES referred Rumford to Constellation as a load response participant and received 5% of Rumford’s DALRP revenues.

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. He was personally familiar with Rumford’s operations, led CES’s attempt to enroll

⁴ During the period covered by Enforcement’s investigation, G4 was owned by a Rumford affiliate, but was controlled and operated by Rumford to meet Rumford’s energy needs.

⁵ See Frequently Asked Questions About Our Restructuring, available at http://www.newpagerestructuring.com/wp-content/uploads/2011/09/Restructuring-FAQ_FDM-Update_FINAL.pdf.

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

Rumford in the DALRP in the spring of 2007, and facilitated Rumford's participation through January 2008.

C. 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.”⁷ 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.⁸

ISO-NE's DALRP was implemented in June 2005 as a supplemental program to ISO-NE's real-time load response programs.⁹ The goal of all of ISO-NE's load response

⁷ *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. The 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).

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

⁹ *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

programs is to “reduc[e] peak electricity demand by large power users.”¹⁰ 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.”¹¹

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 utilized 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.¹² Once an initial baseline was established, the baseline adjusted on a rolling basis using actual load data from the resource.¹³

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.¹⁴ 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

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.

¹⁰ ISO New England Load Response Program Manual at 1-1 (LRP Manual).

¹¹ ISO-NE Tariff, Appendix E to Market Rule 1, § III.E.1.1.

¹² LRP Manual § 4.2.1.

¹³ *Id.*

¹⁴ *Id.*, § 4.2.2.

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.¹⁵ The participant's real-time load was measured against its baseline to quantify the load reduction.¹⁶ 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.¹⁷ 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.¹⁸ 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.¹⁹

Demand response resources participated in the DALRP with assistance from third-parties known as Enrolling Participants.²⁰ 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.²¹ Regarding Rumford's

¹⁵ *Id.*, § 4.5.1.1.

¹⁶ *Id.*, § 4.3.1.3.

¹⁷ 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 at this time, though it remained enrolled in the DALRP program.

¹⁸ LRP Manual § 4.5.1.1.

¹⁹ *Id.*, § 4.5.1.1.

²⁰ *Id.*, § 2.2.1.

²¹ *Id.*, § 4.5.4.

participation, Constellation retained 10% of DALRP revenues as the Enrolling Participant and distributed 85% to Rumford and 5% to CES as Constellation's broker.²²

III. STAFF'S FINDINGS AND ANALYSIS

A. Findings

CES Devised a Scheme for Rumford's DALRP Participation

In mid-2007, Silkman of CES approached NewPage's Senior Counsel, Ron Guay, regarding Rumford's possible ISO-NE load response participation. Silkman developed a scheme for Rumford's DALRP participation based upon curtailing generation from G4 when the baseline was measured by ISO-NE.²³ Rumford would participate in the DALRP by curtailing generation during the initial, five-day baseline creation period and subsequently communicating daily load reduction offers at the minimum offer price.²⁴ The effect of curtailing generation from G4 during the baseline period would be to temporarily increase Rumford's purchases of electricity. This increase would communicate to ISO-NE a higher demand for electricity than was actually the case, resulting in a false and inflated initial baseline.

Once the inflated baseline was established, Rumford would operate G4 as it typically had operated. In effect, this meant that 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.²⁵ Since the baseline would stay static, Rumford could be regularly compensated for its claimed load reduction. Once the baseline was set, Rumford needed only to comply with the ministerial and administrative aspects of the program while operating as usual,²⁶ i.e., there would be no actual reduction of load.

²² Constellation Response to Data Request 7(b).

²³ Silkman Dep. 203:11-14.

²⁴ *See, e.g.*, Alley Dep. 143:13-16.

²⁵ *Id.* at 90-91 and 119-120.

²⁶ Rumford's Utilities Superintendent, Scott Alley, testified that Rumford expected "none, to very limited" changes in its mill or G4 operations due to DALRP participation under the plan outlined by Silkman. *Id.* 139:7-9. Alley also stated that, to

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 based on CES's scheme.²⁷ 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.²⁸

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.²⁹ Rumford commissioned CES to prepare a "White Paper" describing potential load response participation.³⁰ In this paper, CES stated that it had been tracking "zero baseline facilities," (facilities that were neither net importers nor exporters of energy, like Rumford) and concluded that such facilities could participate and receive full compensation.³¹

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 G4.³² Silkman predicted and Rumford anticipated an increased out-of-pocket cost of \$120,000 to purchase additional energy from the grid.³³ Silkman advised that Rumford

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.

²⁷ CES Response to Data Request 2 (describing meetings on June 12 and July 6).

²⁸ CES Response to Data Requests 7(a) and 7(d).

²⁹ Silkman Dep. 166:1-13.

³⁰ *Id.* at 179:4-13. This White Paper was produced by Rumford during Enforcement's investigation. *See* RUMF000001-000003.

³¹ RUMF000001. In response to Enforcement data requests, CES produced no written materials demonstrating research it conducted into "zero baseline facilities" to support this statement.

³² Alley Dep. 126:2-6.

³³ 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).

could expect to recoup this expense within a week of DALRP participation.³⁴ Silkman did not identify any cost or risk associated with Rumford's participation other than the initial cost of increased energy purchases.

After consulting with Rumford operators, CES suggested and Rumford agreed that it would claim 20-30 MW of load response in the DALRP.³⁵ No contemporary written documents produced by CES or Rumford, including the White Paper, mention CES's proposal to curtail G4 during the baseline period,³⁶ although this was a key aspect of Rumford's participation and the parties agree that they intended to curtail generation during the baseline period. This lack of documentation is noteworthy given that the generation curtailment scheme, and the resulting projected revenues, led Rumford personnel to question CES "on numerous occasions about the legitimacy of the program."³⁷ 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."³⁸ 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.³⁹

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 how Rumford should operate to establish its baseline.⁴⁰ Silkman also acknowledged that

³⁴ *Id.*

³⁵ Silkman Dep. 171-72.

³⁶ *Id.* at 239:18-24. 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 them was able to identify the creator; Silkman said that the handwriting "could possibly be" his. *Id.* 245:9-11.

³⁷ Alley Dep. 116:9-15.

³⁸ *Id.* at 116:9-22.

³⁹ *Id.* at 116-117.

⁴⁰ Silkman Dep. 324:4-13.

Rumford management stated to him that it appeared Rumford would be getting paid for doing nothing.⁴¹ 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 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.”⁴²

While Rumford, CES, and Silkman understood that the scheme would result in payments to Rumford and CES essentially for doing nothing, they nevertheless persisted with this approach. None of the parties contacted Constellation or ISO-NE to explore the appropriateness of the strategy in response to Rumford senior managers’ initial reservations. Setting aside Rumford managers’ initial reservations, Rumford and CES fully adopted the Silkman baseline inflation scheme.⁴³

CES, representing Rumford, contacted Constellation and initiated the load response enrollment process with Constellation as Rumford’s Enrolling Participant. One of the reasons CES and Rumford agreed to use Constellation was that Constellation was a large and “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.”⁴⁴ 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 strategy of getting paid for doing nothing was legitimate.⁴⁵

Just before the baseline period, CES and Rumford personnel discussed the information that would be provided to ISO-NE to enroll Rumford.⁴⁶ Although Rumford

⁴¹ *Id.* at 324:14-17; 326-27.

⁴² *Id.* at 324-25.

⁴³ Guay Dep. 52:9-12.

⁴⁴ RUMF000001-000003. *See also* Silkman Dep. 189-90.

⁴⁵ 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.

⁴⁶ *Id.* at 174:2-7.

did not intend to change its operations to actually reduce load after it enrolled in the DALRP, CES (with Rumford's approval) communicated a claimed load response capability for Rumford of 20 MW electronically to ISO-NE.⁴⁷

Consistent with CES's recommendation, Rumford executed an agreement with Constellation in July 2007 permitting Constellation to enroll Rumford in the DALRP. 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%.⁴⁸ 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.⁴⁹ The primary contact at CES regarding Rumford's DALRP participation was Silkman.

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,⁵⁰ Rumford curtailed generation from G4 during the baseline period.⁵¹ 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.⁵² Other than the generator's curtailment, Rumford operated as it otherwise would have absent DALRP participation.⁵³ Other than curtailing generation, Rumford did not increase its load. The curtailment resulted in an atypical load pattern for each of the

⁴⁷ CES narrative Response to Data Requests at 3.

⁴⁸ CES narrative response to Data Requests and Response to Data Request 7(b).

⁴⁹ Silkman Dep. 129-30.

⁵⁰ CES Response to Data Requests 9 and 20.

⁵¹ Guay Dep. 71:3-22; Alley Dep. 110:4-7. Gerald LeClaire, Rumford's Plant Manager and the most senior official at the mill, was aware of this decision. *Id.* at 110:4-7.

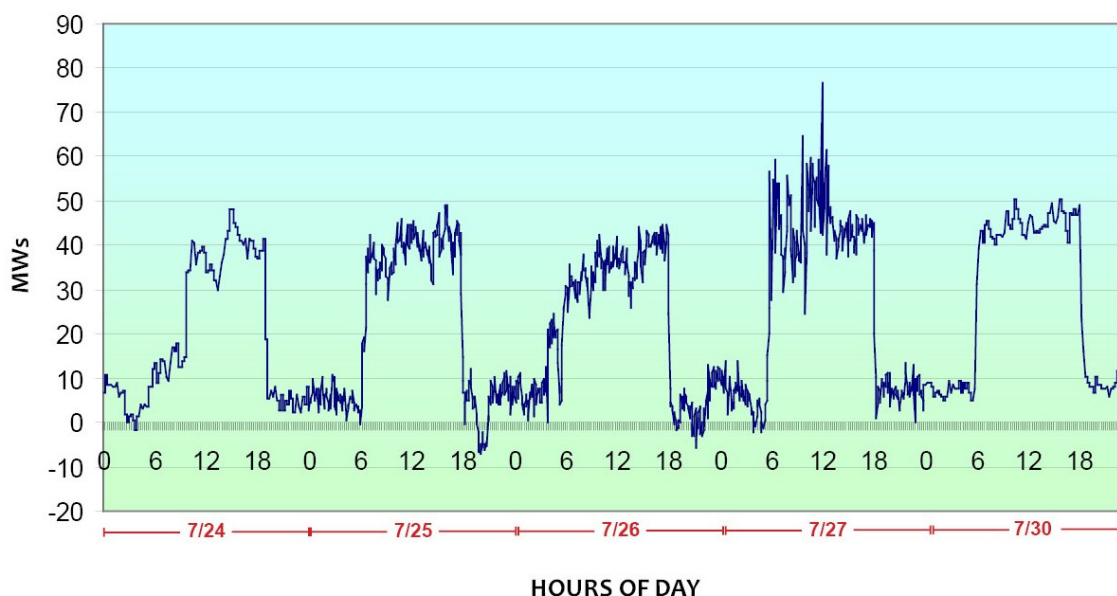
⁵² Rumford Data Responses 36d and e.

⁵³ Guay Dep. 67-68; Rumford Data Responses 35 and 36b.

baseline days, with Rumford's load spiking to 30-45 MW just prior to 7:00 AM, continuing at that level until 6:00 PM, and dropping precipitously to 5-10 MW just after 6:00 PM.⁵⁴ Alley testified that curtailment of G4 during the initial baseline period was always between 25 and "40-ish" MWs and was roughly in the 30-40 MW range overall.⁵⁵ 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.⁵⁶

Table 1⁵⁷ 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



⁵⁴ 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 of data requests to Rumford Paper Company dated April 7, 2008) and 5-minute interval energy data provided by ISO-NE (April 22, 2008).

⁵⁵ 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.

⁵⁶ Silkman Dep. 295:11-19; 207:8-12.

⁵⁷ See December 7, 2011 ISO-NE Data Response.

Table 1 demonstrates the increase in Rumford's load during the five days relied upon by ISO-NE to establish Rumford's baseline.⁵⁸ Just before 7:00 AM on each day, Rumford curtailed generation from G4 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, through early February 2008, Rumford and CES submitted daily, non-holiday weekday load reduction offers for each program hour in the DALRP.⁵⁹ 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). As LMP prices in ISO-NE were virtually always above \$50.00 during program hours, Rumford's offers virtually 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.⁶⁰

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.⁶¹ Rumford did not increase its generation to provide demand response. Likewise, Rumford never reduced its electrical consumption as a consequence of its DALRP participation.⁶² Silkman testified that typical, day-to-day fluctuations in Rumford's operations and energy usage did not require modifications to Rumford's DALRP offers.⁶³ Rumford had no written procedures in place regarding reduction of energy consumption on days when

⁵⁸ Note that Saturday July 28 and Sunday July 29 are excluded from the chart as weekend days are not used to calculate the baseline.

⁵⁹ See RUMF0000926-0000946 (spreadsheet providing Rumford's DALRP offer data); Silkman Dep. 315-16; 320:1-5.

⁶⁰ The latter two instances are discussed below.

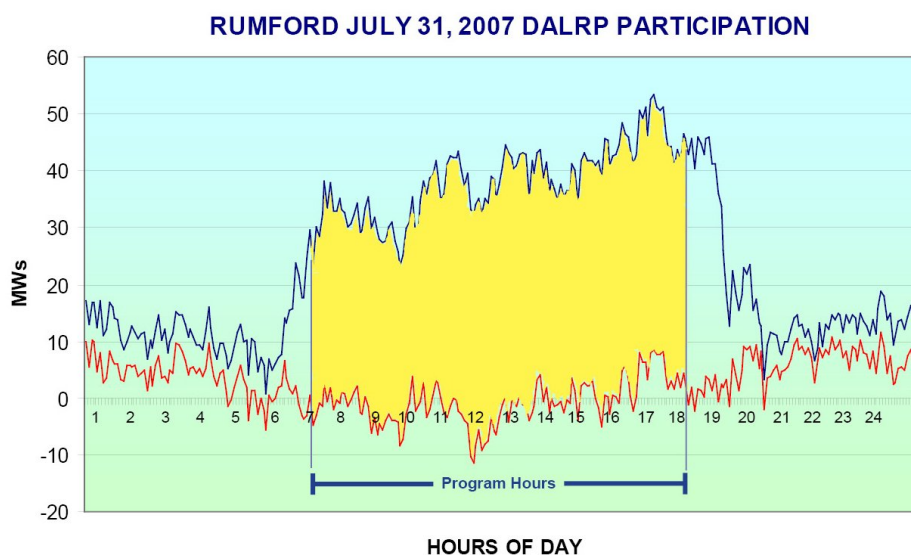
⁶¹ Alley Dep. 140-41; 151:13-24.

⁶² Silkman Dep. 257:13-20; Alley Dep. 140:19-24.

⁶³ Silkman Dep. 319:21-25.

DALRP offers were accepted⁶⁴ and CES admits that it did not anticipate Rumford would reduce energy consumption as part of its DALRP participation.⁶⁵ Rumford's offers were communications to ISO-NE of an availability and willingness or reduce load by a specified amount at a specified price, yet Rumford never intended to and never actually did reduce load when its offers cleared.

Table 2⁶⁶ compares the baseline for Rumford with Rumford's actual load on July 31, 2007 (its 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, 2007.⁶⁷



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.

⁶⁴ *Id.* at 257-58.

⁶⁵ *Id.* at 210-11.

⁶⁶ *See* December 7, 2011 ISO-NE Data Response.

⁶⁷ *See id.*

B. Analysis

Rumford 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.⁶⁸ 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.⁶⁹ Fraud is a "question of fact that is to be determined by all the circumstances of a case."⁷⁰

- 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, Rumford's actions constitute a fraudulent scheme or artifice. Rumford'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 knowingly 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. The baseline is a critical component to determining the load reduction of load response resources and calculating load response payments. The 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

⁶⁸ 16 U.S.C. §824v(a).

⁶⁹ *See Prohibition of Energy Market Manipulation*, Order No. 670, 71 Fed. Reg. 4244 (Jan. 26, 2006), 114 FERC ¶ 61,047 (Jan. 19, 2006) (Order No. 670).

⁷⁰ *See id.* at P 50.

load, CES and Rumford communicated a willingness and ability to reduce load. These communications were false because, as Rumford 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

Rumford knowingly adopted and participated in a scheme that established an inflated DALRP baseline. Rumford knew it would be compensated for doing nothing, i.e., that it would not actually reduce any load when it participated in the DALRP.⁷¹ Instead, Rumford would be paid for phantom load reductions without any appreciable change in the mill's operations.⁷² Rumford understood it would neither increase generation nor decrease electricity consumption as part of Rumford's participation. In sum, Rumford knowingly participated in a scheme with the intent to defraud ISO-NE by getting DALRP payments to which it was not entitled.

While Rumford's intent is clear, scierter is also satisfied through recklessness.⁷³ Recklessness has been defined as "conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care"⁷⁴ 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."⁷⁵ Rumford is a large, sophisticated company and the senior managers involved in the decision to engage in the fraudulent scheme had substantial business and legal experience in electric markets. These managers saw no market benefit in Rumford's scheme and admit that

⁷¹ See, e.g., Alley Dep. 116-117.

⁷² See *id.* 139:7-9.

⁷³ See Order No. 670 at P 53.

⁷⁴ *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).

⁷⁵ *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").

they were concerned about the legitimacy of CES's proposal. In these circumstances, recklessness is evident.⁷⁶

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."⁷⁷ 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.⁷⁸ 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.⁷⁹

⁷⁶ 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).

⁷⁷ 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.

⁷⁸ *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).

⁷⁹ 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

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.⁸⁰ Rumford 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 Rumford's fraudulent activity was in connection with a jurisdictional transaction and violated 18 C.F.R. § 1c.2.

C. Defenses Raised by Rumford

Rumford does not dispute staff's key factual findings. Rumford admits it decided to curtail generation from G4 during the baseline period and purchase additional power from Constellation.⁸¹ Rumford 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, Rumford's baseline remained static.

However, throughout Enforcement's investigation, Rumford has submitted a succession of *post hoc* justifications for its actions. In its response to Enforcement's § 1b.19 notice, Rumford attached each of its six prior written responses to Enforcement's preliminary conclusions letters as well as other documents. These documents

P 47 (2008) (Order No. 719), *order on reh'g*, 128 FERC ¶ 61,059 (July 16, 2009) (Order No. 719-A), *order on reh'g*, 129 FERC ¶ 61,252 (2009) (Order No. 719-B).

⁸⁰ 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).

⁸¹ As discussed above, Rumford managers directed employees to curtail generation during the baseline period. While Rumford now claims that CES and Silkman, not Rumford, made "the decision to ramp generation down when setting the baseline" (Rumford 1b.19 Response at 4), the record discussed above demonstrates Rumford's active agreement with and complicity in the scheme and further that Rumford was aware that the scheme was fraudulent.

demonstrate how Rumford's defenses have evolved over the course of Enforcement's investigation. However, most of Rumford's arguments can be condensed into a simple assertion: its behavior was appropriate.⁸²

Enforcement has reviewed all of Rumford's arguments and finds them to be without merit. Rumford's arguments are voluminous and some are not explicitly linked to § 1c.2's criteria. However, virtually all of Rumford's defenses fall within seven categories discussed below.

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

1. Rumford incorrectly relies upon *post hoc* economic analysis

Rumford's initial defenses centered on a claim that, if Rumford had not participated in the DALRP, it would have regularly curtailed generation from G4 from July 2007 through February 2008.⁸³ In other words, Rumford argued that its baseline genuinely reflected how Rumford would have operated absent participation in the DALRP and, therefore, Rumford actually increased behind-the-meter generation and reduced overall load as a result of its DALRP participation. To support this argument, Rumford relied almost entirely upon affidavits of a retained economist, Julia Frayer.

⁸² Rumford makes one argument unrelated to the merits of its participation in the DALRP. Rumford complains that Enforcement's § 1b.19 notice was deficient because it did not specifically discuss Rumford'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 Rumford of a meaningful opportunity to engage the merits of Enforcement staff's arguments. Rumford § 1b.19 Response at 1-2. Rumford's allegations are patently false and irrelevant to whether Rumford 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 Rumford's defenses. Moreover, while Rumford claims to be unaware of staff's arguments regarding Rumford's defenses, staff has repeatedly explained its positions to Rumford. Rumford 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. Rumford's alleged due process concerns are unfounded.

⁸³ See Letter from Amy Koch, Counsel, Rumford Paper Company, LLC to Gabe Sterling, Staff Attorney, Division of Investigations, Federal Energy Regulatory Commission at 2 (January 19, 2010) (cover letter to Frayer Initial Affidavit); Frayer Initial Affidavit at 9-10; Frayer Dep. 94:8-13.

Rumford claimed that, just prior to its DALRP participation, it was “in the midst of determining” how to operate given new contractual rights that it had obtained regarding the G4 unit and “had not yet changed its operations.”⁸⁴

One of Frayer’s affidavits concludes that, based upon prevailing energy prices and the cost of operating G4, Rumford would have curtailed generation from G4 and purchased replacement energy from Constellation.⁸⁵ Frayer submitted affidavits claiming that G4’s cost of generating more than 60 MW between July 2007 and January 2008 was higher than the cost of purchasing energy would have been. Based upon this analysis, Frayer concludes that Rumford would have curtailed generation from G4 to 60 MW during this period if it had not participated in the DALRP.⁸⁶

As an initial matter, Frayer’s 2010 analysis is irrelevant to Rumford’s intent in 2007-2008. Her analysis is a *post hoc* review of information that was unavailable to Rumford when it contemplated participation in the DALRP. Moreover, Frayer admitted that she had absolutely no first-hand knowledge regarding Rumford’s intent and did not speak to company personnel about the company’s intent.⁸⁷ Additionally, Frayer asked Rumford for specific cost of production data for G4, but Rumford declined to provide the data for her analysis.⁸⁸ Fraudulent intent is a fact-specific inquiry, not a matter of general economic principles, and the contemporaneous facts demonstrate fraudulent intent by Rumford.

Further, Frayer’s data, analysis, and calculations are invalid. Frayer’s analysis of the incremental cost to operate G4 was flawed as she: (1) included the cost of all fuel

⁸⁴ Initial Rumford Response to Staff Preliminary Conclusions at 10.

⁸⁵ The affidavit’s analysis is based upon whether an economically rational actor would have curtailed G4 from 2007-2008 -- not whether Rumford was prepared to curtail generation from G4. Frayer Dep. 76:7-21. Frayer acknowledged that in 2007 Rumford could have prospectively analyzed whether to decide between “self-generating or buying from the market,” but did not. *Id.* at 63:2-20. She also admitted that her analysis could not be used to determine Rumford’s state of mind at the time it began DALRP participation. *Id.* at 83-84.

⁸⁶ See cover letter to Frayer Initial Affidavit at 2; Frayer Initial Affidavit at 9-10; Frayer Dep. 94:8-13.

⁸⁷ Frayer Dep. 53:1-5; 78:22-25.

⁸⁸ *Id.* 48-49.

used at the mill and not just fuel used to operate G4;⁸⁹ (2) assumed that Rumford would use the most expensive fuel before cheaper fuel when it operated G4 to generate more than 60 MW;⁹⁰ and (3) included an unsupported cost for operation and maintenance.⁹¹ While Frayer subsequently modified her analysis to address some of these flaws, many remain.⁹²

Likewise, Frayer's analysis of what it would have cost Rumford to purchase electricity was also flawed. Specifically, she: (1) used an average monthly LMP for the cost of electricity rather than just energy costs during the DALRP program hours, which reduced the purchasing cost by between \$10.00 to \$12.00 per MWh; (2) failed to include a \$1.00 per MWh Constellation surcharge; (3) failed to include additional transmission costs of about \$16.00 per MWh when Rumford purchases electricity; (4) failed to include ancillary services charges of about \$2.00 per MWh; (5) failed to include capacity charges which Rumford estimated to be about \$6.00 per MWh; (6) failed to include taxes; and (7) failed to include line loss charges of about 4 percent.⁹³ Once again, while Frayer subsequently modified her analysis to address some of these flaws, many remain.⁹⁴

In addition, Frayer claimed that Rumford's fraudulent behavior actually benefitted ISO-NE consumers.⁹⁵ But, her analysis assumes, incorrectly, that Rumford provided legitimate demand response. Frayer deems every MW of claimed demand reduction as providing value to ISO-NE when, in fact, Rumford did not substantively change operations as a result of its DALRP participation. As discussed in this Report, all of Rumford's claimed demand response was the result of an inflated baseline scheme. Since Rumford did not reduce load to participate in the DALRP and was effectively paid for "doing nothing," Rumford's participation provided no benefit to consumers.

⁸⁹ See *id.* 160-61; 167: 22-25; 173-74.

⁹⁰ See Frayer Initial Affidavit at 32; Frayer Dep. 163-64.

⁹¹ Frayer Dep. 48-49.

⁹² See, e.g., Frayer Supplemental Affidavit at 2-3; Frayer Dep. 169-70.

⁹³ Frayer Dep. 100-101; 105:17-21; 107-108; 110-111; 120-21; 112:18-21; 113:4-8.

⁹⁴ See, e.g., Frayer Supplemental Affidavit at 4-5 and n. 4.

⁹⁵ Rumford 1b.19 Response at 10-11. Frayer's benefits analysis is relied upon by Rumford's other retained economist, Shanker.

In summary, Frayer's analysis is neither relevant nor accurate.⁹⁶ Frayer's errors underestimate the cost of purchasing replacement energy and overstate the cost of generation from G4. As a result, she incorrectly concluded that it would have been economically efficient for Rumford to curtail G4 if Rumford had not participated in the DALRP. Further, her *post hoc* conclusion that Rumford would have curtailed G4 and purchased replacement energy between August 2007 and January 2008 if it had not participated in the DALRP is contradicted by the contemporary facts discovered in Enforcement's investigation. In fact, Rumford would have almost always operated G4 at full output during the DALRP's hours because it was substantially cheaper to operate G4 to produce electricity for the mill rather than purchase replacement energy from Constellation.⁹⁷

Enforcement believes that Rumford's economic arguments, set forth initially by Frayer and repeated in Rumford's response to the § 1b.19 notice, are after-the-fact rationalizations for Rumford's fraudulent scheme.

2. Rumford's *post hoc* claim that its decision to curtail G4 during the baseline was principled and appropriate

Rumford initially claimed that it actually changed its operations to participate in the DALRP, providing real value to ISO-NE. While Rumford employees did not provide specific, sworn testimony to support this claim, Rumford nevertheless argued that its baseline reflected its expectation that it would have regularly curtailed G4 but for its participation in the DALRP. Rumford argued that, because of changes to contractual arrangements involving the G4 unit, it was on the verge of radically altering how G4 was used just prior to the time in which the baseline was set (i.e., mid-2007). Rumford's *post hoc* claims that it had a legitimate purpose for curtailing G4 during the initial baseline period are unsupported.

First, there is no contemporary documentary evidence supporting Rumford's belated claim that it intended to begin curtailing G4 absent the company's DALRP participation. Internal company documents discussing the DALRP and CES's White Paper do not mention any such intent. In fact, there was no written rationale for curtailing generation during the baseline. Moreover, Enforcement did not uncover, and Rumford was unable to identify, *any* document that specifically contemplated long-term

⁹⁶ Similarly, Shanker's affidavit (which largely relies upon Frayer's analysis) is irrelevant and incorrect.

⁹⁷ See Frayer DALRP Exh. 13 (chart entitled, "Modified Figure 8 without Natural Gas and No. 6 Fuel Oil Consumption Using Corrected Data").

curtailment of G4 in 2007-2008.⁹⁸ In addition, Rumford's documented concerns about the cost of replacement power during the baseline period demonstrate that Rumford believed that operation of G4 was economic. This is inconsistent with the company's argument to Enforcement that it intended to regularly curtail G4 beginning in mid-2007.

Second, Rumford managers have testified that the mill operated no differently during the DALRP from what it would have operated absent DALRP participation.⁹⁹ Rumford personnel agreed that G4 generally operated to meet the mill's entire load because Rumford had decided that operation of G4 was more efficient than purchasing electricity.¹⁰⁰ Silkman's proposal described Rumford as a "zero baseline" facility (using G4 to meet all of the mill's electricity needs).¹⁰¹ Alley, Rumford's Utilities Superintendent, admitted that managers believed that Rumford was getting paid for continuing typical operation of G4¹⁰² and that he anticipated that Rumford would have operated G4 at normal output had Rumford not been participating in the DALRP.¹⁰³ Although Rumford has attempted to discredit the testimony of its own manager on this point, the testimony is credible¹⁰⁴ and the employees have sufficient experience to

⁹⁸ See Rumford Data Response 43(d). Rumford cites to studies it undertook regarding the cost of operating G4. One of these studies did not occur until late 2009 and, thus, is irrelevant to Rumford's intent in mid-2007. The second study evaluated the cost of purchasing the G4 unit and not whether and when to curtail G4. The sole basis for Rumford's assertion that it would have begun curtailing G4 if it had not participated in the DALRP is Frayer's analysis. See, e.g., Rumford's third response to Staff's Preliminary Conclusions at 7; 14-15.

⁹⁹ Alley Dep. 140-41; 151:13-24.

¹⁰⁰ Guay Dep. 29:3-7; Alley Dep. 33:9-12; 34:10-17.

¹⁰¹ RUMF000027.

¹⁰² Alley Dep. 139:10-16.

¹⁰³ *Id.* 118:25-119:4.

¹⁰⁴ Rumford attempts to discredit Alley's testimony by arguing that he did not understand the DALRP and "was not tasked with developing (or qualified to conduct) the economic analysis developed by Dr. Silkman." Rumford first response to Staff's Preliminary Conclusions at 10 (citing Alley Dep. 57:17-22; 59:10-15; 63-65; 67:22-25; 68:14-24). However, Alley accurately described not only his own concerns, but also the concerns of other Rumford managers. With an undergraduate degree in power engineering and a masters degree in business, Alley is a senior manager at the mill

determine that “anytime you hear something that sounds too good to be true, you question it.”¹⁰⁵ Rumford regularly operated G4 to meet the mill’s energy needs before, during, and after its DALRP participation (except during the baseline period). Rumford’s after-the-fact rationalization is inconsistent not only with the contemporaneous record, but sworn testimony provided in this investigation.

Third, contemporaneous documents show that Rumford believed that G4 was a cheap source of energy and intended to operate it to meet virtually all of the mill’s energy needs. Company documents estimated that the incremental cost of running G4 was approximately \$45.00 per MWh.¹⁰⁶ Operating procedures given to G4’s day-to-day operators in May 2007 directed operators to curtail generation and purchase energy from the grid only when the LMP price of power in New England was less than \$40.00 per MWh.¹⁰⁷ Electricity purchase prices virtually always exceeded \$45.00 per MWh during the DALRP program hours when Rumford was in the program. Therefore, under the operating guidelines in effect at the mill, Rumford would have operated G4 at full capacity to meet mill needs if it had not been participating in the program.

Fourth, the repeated skepticism expressed by Rumford managers about the legitimacy of Silkman’s scheme is inconsistent with claims that Rumford’s actions were principled and harmonious with the intent of the DALRP. Managers understood that Rumford was, in effect, getting something for nothing. This belief is at odds with Rumford’s present claim that the baseline measured how much Rumford could “contribute” to the grid.¹⁰⁸

Rumford’s actions were neither principled nor defensible. Although Rumford initially defended its scheme to Enforcement by claiming that Rumford was on the verge

reporting directly to Production Manager, John Fuller. He has seven managers reporting to him and oversees 70-75 employees. *Id.* at 14-16, 19:3-20.

¹⁰⁵ *Id.* at 117:6-7.

¹⁰⁶ *See* Operating Guideline Memorandum from Rick Abradi to Cogen Operators (May 5, 2007) (RUMF0002754).

¹⁰⁷ *Id.* This incremental cost for G4 is substantially lower than the after-the-fact incremental cost to operate G4 calculated by Frayer. Frayer’s Supplemental Affidavit calculates incremental cost for G4 to be between \$66.35 and \$115.01 per MWh. Frayer Supplemental Affidavit at 6 (Fig. 2).

¹⁰⁸ Rumford Data Response 9.

of changing its operation of G4 and its baseline operation reflected that anticipated change, there is no evidence supporting this *post hoc* defense. The contemporary evidence demonstrates that Rumford 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.

Rumford Blames Other Entities and Demand Response Rules

3. Rumford blames ISO-NE and Constellation

Rumford has claimed that its behavior was excused by, or was the result of, other entities' behavior. For example, Rumford claims that it reasonably assumed that its participation in the DALRP had been vetted by CES, Constellation, and ISO-NE.¹⁰⁹ In particular, Rumford, citing the LRP Manual, asserts that Constellation was responsible for "signing up, setting up, training customers and assisting them in developing load curtailment strategies."¹¹⁰

Rumford does not explain why Constellation's alleged failure to meet the LRP Manual's obligations is a defense for Rumford's fraud under 18 C.F.R. § 1c.2. Moreover, staff's investigation revealed no evidence that Rumford actually relied on Constellation or ISO-NE to evaluate Rumford's DALRP participation and Rumford cites none. Rumford could have contacted Constellation or ISO-NE regarding the legitimacy of Silkman's scheme, but it chose not to do so. Rumford cannot blame Constellation or ISO-NE for its own fraudulent behavior.

4. Rumford blames "flaws" in DALRP rules

Rumford also blames ISO-NE for adopting flawed DALRP rules. Rumford argues that the DALRP program rules were flawed and that punishment of Rumford is unwarranted, as any improper Rumford actions were a result of vague program rules.¹¹¹

¹⁰⁹ Rumford first response to Staff's Preliminary Conclusions at 9.

¹¹⁰ *Id.* at 14. Rumford also claims that if Constellation had concerns about Rumford's activities, Constellation should have taken a more proactive role to address those concerns. Letter from Randall Weill, Counsel for Rumford, to Gabe Sterling and Nicole Brisker, FERC OE staff (Aug. 9, 2010) at 2.

¹¹¹ Rumford's first response to Staff's Preliminary Conclusions at 17-22. Many of these arguments are repeated in Rumford's third response to Staff's Preliminary Conclusions at 2-6.

Rumford cites *PJM Interconnection, LLC.*, 126 FERC ¶ 61,275 at P 190, *reh'g denied*, 128 FERC ¶ 61,157 at P 90 (2009), and *Mandatory Reliability Standards for the Bulk-Power System*, 118 FERC ¶ 61,218 at P 125 (2007), for the proposition that tariff provisions should be unambiguous and that tariff “ambiguity can be taken into account in the exercise of the Commission’s enforcement discretion.”¹¹² Rumford argues that ISO-NE’s tariff did not explain “how customers were to operate their equipment during the hours when the initial baseline measurements are to be obtained.”¹¹³ In particular, Rumford cites then-Commissioner Wellinghoff’s statements that baseline methodologies should be accurate and flexible.¹¹⁴ Rumford 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 Rumford’s DALRP participation.¹¹⁵ Rumford states that it did not have any control over ISO-NE’s tariff or electricity market prices. Finally, Rumford claims that Enforcement fails to consider the possibility that on-site generation resources may provide demand response.¹¹⁶

Rumford’s arguments are misplaced. The evidence demonstrates that Rumford 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 Rumford acted recklessly by engaging in the fraud. High energy prices did not cause Rumford’s behavior. Rather, Rumford used high energy prices in New England as an opportunity to implement a scheme to receive demand response payments without providing any load reductions. Rumford 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

¹¹² Rumford’s first response to Staff’s Preliminary Conclusions at 20 (quoting *Mandatory Reliability Standards for the Bulk-Power System*, 118 FERC ¶ 61,218 at P 125).

¹¹³ *Id.* at 18.

¹¹⁴ *Id.* at 19. *See also* Rumford’s third response to Staff’s Preliminary Conclusions at 4-5.

¹¹⁵ Rumford’s first response to Staff’s Preliminary Conclusions at 20-21; Rumford’s third response to Staff’s Preliminary Conclusions at 24.

¹¹⁶ Rumford’s first response to Staff’s Preliminary Conclusions at 21; Rumford’s third response to Staff’s Preliminary Conclusions at 17.

all fraudulent actions that market participants may undertake.¹¹⁷ Indeed, § 1c of the Commission's regulations exists to prohibit market participants from engaging in such fraud.

Further, the evidence demonstrates that Rumford's actions did not arise from ambiguity in the tariff or confusion as to the requirements of the DALRP.¹¹⁸ Rumford doubted the legitimacy of Silkman's scheme and, even when confronted in January 2008 with ISO-NE's and Constellation's concerns about hypothetical schemes *identical to Rumford's scheme*, Rumford's Senior Counsel and managers did not take action.¹¹⁹ Indeed, all Rumford's Senior Counsel did was confirm that those concerns were not directed specifically to Rumford.¹²⁰ And yet, Rumford had no basis for concluding that Constellation was even aware of the details of Rumford's scheme.

¹¹⁷ For example, Rumford 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 for doing something that the ISO-NE tariff explicitly contemplated. *See* Rumford's third response to Staff's Preliminary Conclusions at 24-25. Staff does not allege that Rumford's offers, in isolation, violated § 1c.2. Rather, Rumford's fraudulent scheme consisted of coupling minimum price offers with a fraudulently inflated baseline. The scheme, in its entirety, was fraudulent because it misrepresented Rumford's load and resulted in payments for phantom load reductions.

¹¹⁸ Rumford often conflates violations of ISO-NE's tariff and manuals with violations of § 1c. *See, e.g.*, Rumford's third response to Staff's Preliminary Conclusions at 6 ("Rumford followed the applicable tariffs [sic] for establishing baselines and bidding into the DALRP"), 10 ("Rumford's Initial Customer Baseline Was Set In Accordance with the Load Response Program Manual in Effect at the Time"), and 22 ("Rumford did not intentionally or recklessly violate the Load Response Manual or any other ISO-NE rule"). 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.

¹¹⁹ *See* RUMF0001701-02; RUMF1495-0001497; 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)); Silkman Dep. 385-86; 391:14-24; 392:11-15; 397:3-9.

¹²⁰ Guay Dep. 82:20-22; 84:4-5; 85:8-20.

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

Rumford 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, Rumford emphasizes a 2008 ISO-NE tariff filing explaining that some baseline methodologies for demand response programs are complex.¹²¹ Because of this alleged complexity, Rumford appears to claim that its actions cannot be deemed fraudulent.

Rumford 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 Rumford misunderstood the baseline calculation process. In fact, Rumford'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 Rumford, but the scheme was simple: 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. Rumford managers understood this scheme, initially questioning the scheme as too good to be true before embracing it. While Rumford now claims that its participation required a complicated curtailment scheme and large uneconomic purchases of energy to set a baseline, there is no contemporary evidence backing up this assertion. Rumford's conduct was not the result of confusion or mistake; it was deliberate, calculated fraud.

Rumford's Interpretation of Order No. 745

6. Rumford claims that Order No. 745 absolves Rumford of its behavior

In its May 5, 2011 supplemental response to Enforcement's preliminary conclusions letter, Rumford argued for the first time that the company's 2007-2008

¹²¹ Rumford 1b.19 Response at 4-5 (quoting *ISO New England, Inc.*, 123 FERC ¶ 61,021 at P 29 (2008)).

behavior is consistent with the Commission's order on compensation for demand response resources (Order No. 745) issued in 2011.¹²²

Rumford claims that it and Silkman could appropriately "set" the demand response baseline to be compensated for all on-site generation. Or, as Rumford's newly-retained expert argues, "every MWh that Rumford generates results in a MWh less of load on ISO-NE's grid."¹²³ Rumford even argues that it implemented its scheme with restraint, and that it would have been "justified [to] turn its generator totally off when the baseline was being set"¹²⁴ resulting in an even more inflated baseline. Under Rumford'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. Rumford 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 Rumford, and particularly for a [demand response] market design like the DALRP."¹²⁵

Rumford's Order No. 745 argument appears to be inconsistent with Frayer's assertion that Rumford would have operated its generator differently in 2007-2008 if it had not participated in the DALRP. As discussed above, Frayer and Rumford previously argued that Rumford provided real demand response because it increased G4 output above what it otherwise would have absent DALRP participation. However, Rumford now claims that Order No. 745 justifies payment to Rumford despite the fact that it did not intend to change its operations as a result of DALRP participation. Either Rumford intended to reduce G4's output or it intended to operate G4 in the same manner as it had previously – Rumford could not have had both intentions. The evidence establishes that Rumford intended to continue to operate G4 at full output to meet the mill's electricity needs regardless of Rumford's DALRP participation.

Setting aside the inconsistency of Rumford's defenses, Rumford'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 Rumford's behavior. Order No. 745 was issued in 2011, more than three years following the conclusion of Rumford's fraud. Further, Order No. 745

¹²² See Rumford's fifth response to Staff's Preliminary Conclusions, *passim*. See also Rumford 1b.19 Response at 2-11.

¹²³ *Id.* at 7.

¹²⁴ *Id.*

¹²⁵ *Id.* at 5.

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.¹²⁶ 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.”¹²⁷

Second, neither Order No. 745 nor any other Commission order or policy permits participation in demand response programs without reducing demand. As Rumford and Silkman knew, the purpose of demand response is to reduce energy consumption from the grid. However, the essence of Rumford's *post hoc* argument is that it was permissible for Rumford to be paid without actually reducing load. In fact, the only change in load caused by Rumford's participation was an *increase* in load during the baseline period by Rumford's purchase of \$120,000 of uneconomic replacement power. Order No. 745 does not permit (retroactively or prospectively) such fraud.

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

IV. SANCTIONS

A. Civil Penalty

Seriousness Factors

Rumford'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 Rumford's violation guide staff's application of the Chapter Two guideline:

¹²⁶ Order No. 745 at P 94.

¹²⁷ *Id.* at P 95 (citing 18 C.F.R. § 1c.2).

- Rumford'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).
- Rumford'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 Rumford's culpability and guide application of the Penalty Guidelines to derive a culpability score:

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

Regarding the compliance program factor, Rumford has policies and procedures regarding safety and environmental issues relating to its core business as a paper mill¹²⁸ and corporate training to comply with its Sarbanes-Oxley obligations,¹²⁹ but the company did not have a formal compliance program or an individual charged with overall corporate regulatory compliance procedures. More specifically, Rumford provided no training or guidance to personnel responsible for managing Rumford's participation in the DALRP.¹³⁰

¹²⁸ Guay Dep. 120:9-11. NewPage has a compliance committee in its legal department. *Id.* at 120:12-15.

¹²⁹ Guay Dep. 120:4-8.

¹³⁰ *Id.* at 122: 5-11.

Rumford has market-based rate authorization granted by Commission-delegated order in Docket No. ER06-761-000 on June 15, 2006.¹³¹ Rumford is, therefore, a seller of electricity subject to the Commission's jurisdiction. Rumford personnel have engaged in other energy transactions including acquisition and sales of hydroelectric facilities near the mill and purchase and sale of energy from G4 under contracts with Constellation. Rumford understands real-time energy pricing and, since at least 2006, mill operators have received detailed instructions on when to purchase energy from the grid instead of operating internal generation. Rumford is a large, sophisticated industrial consumer of energy and is experienced in energy markets and energy programs. However, Rumford had no energy-related compliance program. Rumford voluntarily participated in the Commission-approved ISO-NE DALRP and should have developed reasonable, tailored procedures for compliance with the program and Commission regulations.¹³²

Staff recommends a civil penalty of \$13.25 million. The breadth of senior management involvement is substantial in this matter, including participation of in-house legal counsel for Rumford. The evidence demonstrates that multiple Rumford managers understood that Rumford's participation was inappropriate and would result in consumers in New England paying for a non-existent product (i.e., phantom load response). The individuals and entities harmed by Rumford'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 \$13.25 million within the Penalty Guidelines' range is appropriate.

B. Disgorgement

The entirety of Rumford's DALRP-related revenue from July 2007 through February 2008 was fraudulently obtained. Consequently, Rumford should disgorge \$2,836,419.08 in unjust profits, plus interest under § 35.19(a) of the Commission's regulations.

¹³¹ See Letter order from Steve Rodgers, Director, Division of Tariffs and Market Development – West to Todd J. Griset, Re: Market-Based Rate Authorization, Docket No. ER06-761-000 (June 15, 2006).

¹³² See *Compliance with Statutes, Regulations, and Orders*, 125 FERC ¶ 61,058 (2008) at P 8-12.

B. Rumford's Arguments Regarding Sanctions

Rumford 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.¹³³ Enforcement disagrees based upon the foregoing discussion and the facts uncovered during its investigation.

Rumford also argues that Enforcement's penalty calculation under Penalty Guideline is incorrect for three “main” reasons: (1) there was no market harm caused by Rumford's behavior; (2) there is “no transparency problem”; and (3) there is no “senior management involvement.”¹³⁴ Enforcement disagrees as: (1) Rumford's fraud resulted in consumers paying over \$3.3 million for phantom load response; (2) the penalty is not based upon an adder for lack of transparency; and (3) involvement of high-level personnel is clear, including, but not limited to, the involvement of Fuller and Guay.

D. Rumford Bankruptcy

On September 7, 2011, Rumford and its parent company, NewPage, voluntarily filed for bankruptcy protection in United States District Court in Delaware under Chapter 11 of the Bankruptcy Code. Rumford and NewPage have continued, and expect to continue, operations under court supervision throughout their restructuring.¹³⁵

Under the Penalty Guidelines, the Commission will reduce the civil penalty if the penalty would impair the ability of Rumford to disgorge its unjust profits and may reduce the penalty if the penalty would “substantially jeopardize the continued existence of the organization.”¹³⁶ Although Rumford is in voluntary bankruptcy, a downward departure from the Penalty Guideline range is inappropriate. First, Rumford has not argued to date that its imposition of a civil penalty would prohibit either disgorgement of unjust profits or adversely affect Rumford's continued operation. Second, while NewPage and Rumford are reorganizing, the proposed civil penalty would be only a small addition to Rumford's outstanding liability and a tiny fraction of the corporate family's value. Rumford is a wholly-owned subsidiary of NewPage, one of the largest producers of paper

¹³³ Rumford 1b.19 Response at 11.

¹³⁴ Rumford's third response to Staff's Preliminary Conclusions at 21-22.

¹³⁵ See NewPage Press Release available at http://www.newpagerestructuring.com/wp-content/uploads/2011/09/Filing-News-Release_FINAL.pdf.

¹³⁶ See § 1C3.2 and application note 1.

products in North America. The companies share revenues for accounting purposes.¹³⁷ In recent years, NewPage had approximately \$3 billion in sales annually. The parent company owns ten paper mills in Kentucky, Maine, Maryland, Michigan, Minnesota, Wisconsin, and Nova Scotia, Canada.¹³⁸ One of NewPage's recent public submissions with the Securities and Exchange Commission shows that the company has \$3,795,000,000 total assets.¹³⁹ Third, Rumford and NewPage will reorganize under the bankruptcy court's processes and all of the companies' liabilities, including Rumford's liability for civil penalties and disgorgement will be subject to potential reduction consistent with a court-approved plan of reorganization. Fourth, Enforcement would not oppose permitting Rumford to pay the proposed penalty over a multi-year period.

Should the Commission require disgorgement and/or impose a civil penalty by Rumford, Enforcement will pursue this matter consistent with applicable bankruptcy law procedures. Commission staff has filed a Proof of Claim in Rumford's bankruptcy proceeding, preserving the Commission's claim and alerting Rumford's creditors of the claim. In these circumstances, no downward departure from the Penalty Guideline range is appropriate.

V. RECOMMENDED ACTION

Based on the above, Enforcement recommends the Commission issue Rumford an Order to Show Cause why it did not violate 18 C.F.R. § 1c.2 in connection with Rumford's fraudulent participation in the DALRP, and why the Commission should not require Rumford to pay a civil penalty of \$13,250,000 and disgorge \$2,836,419.08 plus interest. Enforcement also recommends the Commission make this Report public pursuant to 18 C.F.R. § 1b.20 and afford Rumford the opportunity to respond to staff's findings.

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

¹³⁷ Guay Dep. 124:3-10.

¹³⁸ See <http://www.newpagecorp.com/aboutus/>.

¹³⁹ See NewPage Corporation, Form No. 10-Q, at p. 3-4, submitted November 4, 2010 (available at www.sec.gov/edgar and www.newpagecorp.com/investors). NewPage's SEC filings provide cumulative data for all NewPage companies in the aggregate, including Rumford.

(a) Rumford, 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 Rumford's participation in ISO-NE's DALRP.

(b) Rumford, 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 \$13,250,000, 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 Rumford's response, be required to file an answer to Rumford's answer.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Rumford Paper Company

Docket No. IN12-11-000

(Issued July 17, 2012)

LaFLEUR, Commissioner, *concurring*:

The Commission must be vigilant in protecting customers from fraud. With respect to demand response, that vigilance includes careful attention to measurement and verification. At a time when customers are increasingly relying on demand response as a significant resource in the energy, capacity, and ancillary service markets, it is particularly important that the load reduction receiving compensation be real and verifiable. I join the majority in directing Rumford 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.

While the Commission must vigorously pursue potential fraud, it must also exercise its civil penalty authority with care and due regard for the circumstances of the alleged violation. I write separately because I disagree with the majority's calculation of the proposed civil penalty in this case.

The majority's application of the Penalty Guidelines¹ in this case double counts the duration of Rumford's alleged fraud. First, the Guidelines increase Rumford'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 Rumford's violation level according to the number of days the fraud persisted. Thus, duration is counted twice.

I believe the majority should have instead exercised its inherent discretion to apply the Penalty Guidelines without the separate duration adder, and proposed a civil penalty from within this corrected range.

I. Rumford's Alleged Fraud

The Staff Report alleges that Rumford and Competitive Energy Services, LLC (CES) devised a scheme to fraudulently profit from ISO New England's Day-Ahead Load Response Program. According to the Report, Rumford curtailed its behind-the-meter generation when ISO New England measured Rumford's baseline, or average demand from the grid. This created the false appearance that Rumford regularly purchased more from the grid than it actually did. The Report then alleges that Rumford resumed normal use of its behind-the-

¹ *Enforcement of Statutes, Orders, Rules, and Regulations*, 132 FERC ¶ 61,216 (2010) (*Revised Policy Statement on Penalty Guidelines*).

meter generation after establishing its baseline, creating the false appearance that Rumford was reducing demand from the grid when it was actually returning to normal operations and normal levels of demand.

The Report further alleges that Rumford's scheme was successful for approximately seven months because its offers to provide demand response were virtually always accepted by ISO New England. The Report explains that Rumford almost always cleared the market because it almost always submitted offers at the minimum price, and prices in New England almost always exceeded these minimums. Under the then-existing rules of the Day-Ahead Load Response Program, ISO New England adjusted a participant's baseline only when the participant did not clear. Since Rumford almost always cleared, its baseline remained static.

II. The Majority's Application of the Penalty Guidelines Double Counts Duration

In cases that do not involve a natural person, the Commission selects and imposes a civil penalty from a range calculated according to the Penalty Guidelines. The range is the product of two factors: a base penalty and minimum and maximum multipliers that correspond to an entity's culpability score. The double counting in this proceeding occurred in calculating the base penalty, and more particularly, in calculating the violation level that yields the base penalty.²

The Penalty Guidelines assign a base violation level to each type of prohibited conduct. The Guidelines then direct the Commission to increase the base level by adding points for adders specific to the violation. The Guidelines enumerate the relevant adders and prescribe the corresponding increases.

Here, Rumford is alleged to have committed fraud. The Guidelines assign fraud a base violation level of 6.

As relevant here, the Guidelines allow fraud to be enhanced by two adders. First, fraud can be enhanced by the magnitude of the monetary loss attributable to it. The Staff Report alleges that Rumford's fraud resulted in a loss to customers of \$3,336,964.63. This corresponds to an 18-point adder. Second, fraud can be enhanced by duration. Rumford's fraud is alleged to have continued for more than 50 days, but less than 250 days. This corresponds to a 4-point adder.

Once the adders are applied, the Penalty Guidelines direct the Commission to a table that prescribes the dollar amount associated with each final violation level. This dollar amount

² The base penalty is the greatest of three variables: (1) the pecuniary gain to the entity under investigation; (2) the pecuniary loss caused by the alleged violation; or (3) the dollar amount corresponding to the entity's violation level. In this case, the greatest amount is the cumulative dollar amount corresponding to Rumford's violation level.

is the base penalty³ applied to the relevant multipliers. Because the Guidelines have a logarithmic structure, the adders can have a significant effect on the size of the base penalty, and by extension, on the parameters of the penalty range and final civil penalty.

I disagree with the majority that Rumford's alleged fraud should be enhanced by both the magnitude and duration adders. Whereas the majority proposes to apply both adders, I would apply only the magnitude adder.

While consistent with a mechanical application of the Penalty Guidelines, I believe applying both adders double counts duration. The Staff Report claims that customers paid Rumford \$3,336,964.63 in fraudulent demand response payments. The magnitude of this loss is directly attributable to how long Rumford perpetuated its alleged fraud. According to the Staff Report, for approximately seven months Rumford submitted daily weekday demand response offers for each hour in the Day-Ahead Load Response Program and these offers almost always cleared. Thus, Rumford was paid for its fraud virtually every weekday for seven months. Had Rumford's alleged fraud occurred over a shorter period of time, the loss to customers would have been diminished accordingly. Thus, in this case, the magnitude of the loss already accounts for the duration of the fraud.

Rumford's violation level with both adders is 28. This corresponds to a base penalty of \$6,300,000. When multiplied by the applicable minimum and maximum multipliers, the base penalty yields a penalty range of \$8,820,000-\$17,640,000. The majority's proposed \$13,250,000 civil penalty is within this range.

In contrast, Rumford's violation level without the duration adder is 24. This corresponds to a base penalty of \$2,100,000 and a penalty range of \$2,940,000-\$5,880,000. I would propose a civil penalty from within this range.

III. The Commission May Use Discretion to Depart From the Penalty Guidelines

By its own terms, the policy statement promulgating the Penalty Guidelines does not purport to limit or displace the Commission's inherent enforcement discretion.⁴ Instead, it

³ See *supra* n. 2.

⁴ *Revised Policy Statement on Penalty Guidelines*, 132 FERC ¶ 61,216 at P 2 (“At the same time, the modified Penalty Guidelines do not restrict our discretion to make an individualized assessment based on the facts presented in a given case.”); P 32 (“As we emphasize throughout the Revised Policy Statement, our decision to adopt a guidelines-based approach does not restrict the discretion that we have always exercised and will continue to exercise in order to make an individualized assessment based on the facts presented in a given case.”).

repeatedly affirms the Commission's freedom to follow or depart from the Guidelines.⁵ Additionally, unlike a rulemaking, a policy statement requires the Commission to justify its use with each application.⁶ Thus, the use of the Guidelines themselves is discretionary.

In the context of the Penalty Guidelines, the requirement to justify their use in each instance requires the Commission to pay due regard to the circumstances of the alleged violation. 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, for the reasons explained above, I do not believe duration has independent value here. Consequently, I believe the majority should have exercised its discretion to apply the Guidelines without the duration adder.

IV. Conclusion

This case is one of the first in which the Commission has applied its Penalty Guidelines in a show cause order. While I voted for the Guidelines and support their continued use, I expect there are issues in their application that will come to light only with experience. I believe we have encountered such an issue in this case. For the reasons discussed above, the majority should have exercised its discretion and applied the Penalty Guidelines without the duration adder. It should have then proposed a civil penalty from this modified range.

Accordingly, I respectfully concur.

Cheryl A. LaFleur
Commissioner

⁵ *Id.* P 31 (“The Commission can also depart from the Penalty Guidelines in the absence of a staff recommendation or contrary to staff’s recommendation.”); P 32 (“Generally, we recognize that the Penalty Guidelines may not always account for the specific facts and circumstances of every case. This is an inevitable feature of a guidelines-based approach to determining penalties. It may be appropriate to depart from applying the Penalty Guidelines where they do not account for significant circumstances surrounding a violation, which is why we include the flexibility to depart as necessary.”).

⁶ *Id.* P 211 (“This is a policy statement. Consistent with the APA, when the Commission applies the Penalty Guidelines in orders, we will present why it is appropriate to apply the Penalty Guidelines and will justify their application in the particular circumstances at hand.”).

Document Content(s)

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