

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

ISO New England Inc.

Docket No. ER07-116-000

ORDER ACCEPTING AND SUSPENDING TARIFF REVISIONS, SUBJECT TO
REFUND, AND ESTABLISHING PAPER HEARING

(Issued December 21, 2006)

1. On October 31, 2006, ISO New England Inc. (ISO-NE) filed revised tariff sheets to collect its administrative costs for the calendar year 2007 (October 31 Filing). In its filing, ISO-NE requests temporary waiver of a billing policy provision in order to delay billing customers for new Financial Transmission Right (FTR)-specific charges. In this order, the Commission accepts ISO-NE's proposed tariff revisions for filing, suspends the October 31 Filing for a nominal period, to become effective January 1, 2007, subject to refund, and establishes a "paper" hearing. The Commission also grants temporary waiver of the billing policy provision.

Background

2. In its October 31 Filing, ISO-NE proposed changes to section IV.A of its Transmission, Markets and Services Tariff (Tariff) to collect its administrative costs for the calendar year 2007 (2007 Revenue Requirement). ISO-NE states that its 2007 Revenue Requirement is \$114.9 million. The proposed 2007 Revenue Requirement is composed of several elements: the 2007 "Core Operating Budget" (\$87.7 million);¹

¹ ISO-NE notes that the 2007 Core Operating Budget reflects a 4.8 percent increase from 2006, necessitated primarily by Forward-Capacity Market-related operations.

“Debt Service” (\$32.5 million);² “True-Up Amounts” for 2005 and 2006 (–\$3.6 million and – \$1.6 million, respectively);³ and the incremental amount of prior year depreciation not recoverable under the Tariff (approximately \$3,500).

3. In support of its filing, ISO-NE notes that its 2007 Operating Expense Budget was broadly endorsed by the New England Power Pool (NEPOOL) Participants Committee, its primary stakeholder body, with 97.73 percent voting to support, and was approved by ISO-NE’s Board of Directors.

4. ISO-NE requests an effective date of January 1, 2007 for the proposed revisions. ISO-NE also requests that the Commission accept the revised tariff sheets without suspension and not subject to refund, citing comments from the New England Power Pool Participants Committee from 2004⁴ and past Commission treatment of ISO-NE budgets in support of its request.⁵ ISO-NE states that if the Commission decides to set any issues for hearing, it should establish a paper hearing.

5. ISO-NE also requests temporary waiver of section 2.2 of its Billing Policy⁶ to account for one specific change to section IV.A of the Tariff -- a new methodology for recovering costs ISO-NE incurs operating the FTR auction. According to ISO-NE, under the new methodology, entities choosing to submit FTR bids will now pay per-unit fees

² ISO-NE reports that its Debt Service includes the following components: (1) recovery of depreciation; (2) amortization of regulatory assets and interest expense necessary to repay principal and interest on Commission-approved capital borrowings; and (3) working capital borrowings.

³ ISO-NE reports that the True-Up Amounts represent a final reconciliation as a result of over-recovery of expenses through rate collections in each of these calendar years, calculated pursuant to section IV.A.2.2(2) of the ISO-NE Tariff.

⁴ ISO-NE states, “[T]his approach is consistent with NEPOOL’S recommendation to the Commission that ‘contested budget increases should not be implemented subject to “refunds”’ because of the ISO’s non-profit status, which means that any money already spent “can only be reallocated among the stakeholders, negating any true refund.” ISO-NE October 31, 2006 Transmittal Letter at n 17 citing NEPOOL Participants Committee Nov. 9, 2004 Comments, Docket No. RM04-12-000, at 3.

⁵ ISO-NE October 31, 2006 Transmittal Letter at n 18.

⁶ Section 2.2 of section I, Exhibit 1D of ISO-NE’s FERC Electric Tariff No. 3.

tied to actual market activity, and ISO-NE will use the revenues associated with these fees to recover its costs of operating the FTR auctions. The new FTR billings would consist of first, a charge for each FTR auction bid (i.e., a per-unit fee), and second, a charge for each accepted FTR bid that clears the market. ISO-NE states that it has been developing software in order to assess the FTR-related charges, and that ultimately, it will assess these charges in accordance with its billing policy through monthly billing. ISO-NE notes, however, that it might not be able to implement the software in time to include the new FTR charges with the monthly bills for the first few months of 2007. Therefore, ISO-NE requests a limited and temporary waiver from section 2.2 of its Billing Policy in order to delay by 90 days the date for billing customers for new FTR-specific charges. ISO-NE states that this waiver, if granted, would provide it additional time to develop and implement necessary software without delaying the requested January 1, 2007 effective date.

Notice of Filing, Interventions, Protest and Answer

6. Notice of the ISO-NE's October 31 Filing was published in the *Federal Register*, 71 Fed. Reg. 65,487 (2006), with interventions, comments or protests due on or before November 21, 2006. Timely motions to intervene were filed by Exelon Corporation and by Northeast Utilities Service Company on behalf of the Northeast Utilities Companies.⁷ The NEPOOL Participants Committee filed a timely motion to intervene and comments in support of the filing. New England Advocates⁸ filed a timely motion to intervene and protest. ISO-NE submitted an answer to New England Advocates' protest.

7. In their protest, New England Advocates argue that ISO-NE's filing does not provide enough supporting evidence for its proposed costs, and as such, the Commission does not have enough information to determine whether they are just and reasonable. New England Advocates ask the Commission to investigate the following areas: proposed depreciation and amortization expenses; staffing levels; senior staff salary structure; professional fees; and service and consultant contracts. New England Advocates request that the Commission set each of these matters for hearing. ISO-NE's

⁷ The Northeast Utilities Companies are: Connecticut Light and Power Company, Western Massachusetts Electric Company, and Public Service Company of New Hampshire.

⁸ The New England Advocates consist of the Attorney General of the Commonwealth of Massachusetts, Richard Blumenthal, Attorney General for the State of Connecticut, the Connecticut Office of Consumer Counsel, the Maine Public Advocate, and the New Hampshire Office of Consumer Advocate.

answer to New England Advocates' protest responds to each of the issues raised in the protest.

8. Regarding depreciation and amortization expenses, New England Advocates claim that ISO-NE's proposed expenses are unreasonably high due to inappropriately short average service lives and zero net salvage value for all of ISO-NE assets. New England Advocates point to a variety of ISO-NE assets for which it asserts the average service lives are too short to be reasonable (e.g. ISO-NE uses a three-year average service life for computers, software, and automobiles, and ten years for Buildings and Structures). Furthermore, New England Advocates argue that depreciation expense and accrual rates are unreasonably high because ISO-NE has determined that none of its assets have any net salvage value, when in fact some of those assets are clearly valuable at the end of their estimated useful lives.

9. In its answer, ISO-NE states that New England Advocates misunderstand certain average service lives ISO-NE uses. Regarding its newly constructed office building (*i.e.*, the Buildings and Structures account), ISO-NE states that the building is actually amortized over twenty-five years, not ten as New England Advocates contend. The ten year amortization period applies to improvements made to leased office space that ISO-NE is using until it completes its move in 2007 to its new office building. Regarding the average service life for ISO-NE owned automobiles, ISO-NE explains that it owns one vehicle -- a Ford Taurus it purchased used -- and contends that a three year average service life is just and reasonable for this vehicle. Regarding net salvage values, ISO-NE explains that as a not-for-profit entity with no equity of its own, it must purchase all assets with debt and typically "uses up" all assets so that they in fact have no salvage value. According to ISO-NE, any residual net value for an item traded in is simply used to lower the lease payments for the replacement item. ISO-NE states that were it to maintain a net salvage value for its assets, it would have to in turn carry more long-term debt to support those values, which would increase customers' long-run costs.

10. Regarding compensation to senior staff for 2007, New England Advocates state that the proposed incentive payments in combination with the base salaries are excessive. New England Advocates state the Commission should not approve such large segments of total compensation in the form of incentive payments when ISO-NE faces very few risks and uncertainties in its operation, given that it receives its revenues under a Commission-approved tariff, is a monopoly service provider, is not required to be profitable, and has no shareholders to judge its performance. New England Advocates argue that ISO-NE has not identified behavior that the incentives are designed to encourage or that might justify a fifty percent (or more) increase to the base salary. According to New England Advocates, ISO-NE has not provided enough supporting evidence for the Commission to determine whether the proposed employee compensation

is just and reasonable. In its answer, ISO-NE responds by pointing to arguments and explanations already contained in its October 31 Filing (discussed below).

11. New England Advocates state that ISO-NE provided no evidence or testimony to support its proposed \$3.5 million non-project capital expense.⁹ ISO-NE responds by explaining that while the present filing mentions this expense, another ISO-NE filing with the Commission, Docket No. ER07-115-000, actually seeks Commission acceptance of and provides supporting evidence for the non-project capital expenditure.

12. New England Advocates also state that ISO-NE did not explain its bidding process for retaining consultants and professionals, and choosing maintenance contracts. New England Advocates thus state that without transparency in the bidding process or supporting documentation that the ISO-NE obtained the most efficient fee arrangement and contracts, the Commission cannot determine whether the \$17.3 million of costs associated with professional fees and consultant contracts are just and reasonable. In its answer, ISO-NE notes that it has kept up-to-date versions of its Purchasing Policy posted on its website for stakeholder review since 1997, and that through this policy it obtains just and reasonable rates for the services it receives.¹⁰

13. Finally, New England Advocates contend that ISO-NE has not provided supporting documentation to justify the following increases in staff: COO administration by 25 percent; resource adequacy by 70 percent; market administration by 36 percent; and market design by 600 percent. ISO-NE answers that its October 31 Filing provides ample support for its net increase of 13 additional staff members and that New England Advocates fail to consider accompanying budget staffing reductions in other departments (as explained in Mr. Ludlow's testimony) when listing percentage increases. ISO-NE states that the October 31 Filing explains that ISO-NE needs 11 of the 13 new positions to operate its new Forward Capacity Market (FCM), and that the remaining two positions are to help operate Phase II of the Ancillary Services Markets project.

14. New England Advocates request hearing proceedings to determine whether all of the aforementioned costs and expenses are just and reasonable.

⁹ See ISO-NE October 31, 2006 Filing at Exhibit 3 RCL-5, Schedule 6.

¹⁰ The current version is available at:
http://www.isone.com/aboutiso/vendor/pol_proc/purchasing_policies_2182005.doc.

Discussion

A. Procedural Matters

15. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,¹¹ the timely unopposed motions serve to make the entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure¹² prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept ISO-NE's answer because it has provided information that assisted us in our decision-making process.

B. Analysis

16. The Commission finds that ISO-NE's proposal to delay by 90 days the billing of customers subject to the new FTR-specific charges to be reasonable in the circumstances described by ISO-NE, and will accept the proposal.

17. With respect to ISO-NE's proposed depreciation and amortization expenses for 2007, we do not believe that ISO-NE's answer adequately addresses the concerns New England Advocates raise, namely that the relatively short average service lives and zero net salvage values used by ISO-NE may result in excessive amounts of depreciation and amortization expenses for 2007. Because these are issues of material fact that cannot be resolved based on the record before us, we will set the matter for a paper hearing, as ordered below. The paper hearing shall specifically address what the appropriate average service lives and net salvage values should be for the assets listed in ISO-NE's 2007 Revenue Requirement. A trial-type hearing is not necessary to resolve this matter.¹³

¹¹ 18 C.F.R. § 385.214 (2006).

¹² 18 C.F.R. § 385.213(a)(2) (2006).

¹³ The use of a "paper" hearing rather than a trial-type evidentiary hearing has been addressed in numerous cases. *E.g.*, *Public Service Company of Indiana*, 49 FERC ¶ 61,346 (1989), *order on reh'g*, 50 FERC ¶ 61,186, *opinion issued*, Opinion 349, 51 FERC ¶ 61,367, *order on reh'g*, Opinion 349-A, 52 FERC ¶ 61,260, *clarified*, 53 FERC ¶ 61,131 (1990), *dismissed*, *Northern Indiana Public Service Company v. FERC*, 954 F.2d 736 (D.C. Cir. 1992). As the Commission noted in Opinion No. 349, 51 FERC at 62,218-19 and n.67, while the FPA and the case law require that the Commission provide the parties with a meaningful opportunity for a hearing, the Commission is required to reach decisions on the basis of an oral, trial-type evidentiary record only if the material

(continued)

Rather, we believe that a paper hearing will allow us to determine whether ISO-NE's depreciation and amortization expenses are just and reasonable. The Commission requires ISO-NE to file a response to the issues set forth for paper hearing by January 22, 2007. Parties may file comments by February 5, 2007. Reply comments may be filed by February 19, 2007. Upon completion of the paper hearing, the Commission shall issue a final order on the matter.

18. We find that ISO-NE has adequately supported its compensation packages for senior staff and therefore will not set this matter for hearing. As explained in its transmittal letter, ISO-NE must comply with IRS standards governing the reasonableness of total compensation for executives.¹⁴ To ensure compliance, ISO-NE engaged a nationally recognized independent consulting firm, which evaluated the compensation offered by similarly situated entities, including other independent system operators and RTOs. The resulting opinion of the consulting firm is that ISO-NE's executive compensation is within a reasonable range of competitive practices for functionally comparable positions among similarly-situated entities. Moreover, ISO-NE reviewed survey data from several national compensation consultants and benchmarked its executive compensation packages against nationwide data for both all-industry and utility-specific employers to ensure that it provided adequate compensation to attract and retain the capable and qualified candidates necessary to ensure reliable and effective operation of ISO-NE. Based on this evidence, the Commission finds ISO-NE's proposed level of executive compensation to be just and reasonable.

19. With respect to New England Advocates' assertion that ISO-NE has not adequately supported the \$3.5 million of non-project capital expenses, we note that the issue is not properly before the Commission in this proceeding. ISO-NE's 2007 Revenue Requirement does not provide for recovery of the \$3.5 million. Rather, this issue properly resides in Commission consideration of ISO-NE's 2007 Capital Budget filing in Docket No. ER07-115-000, where ISO-NE provides an explanation of the non-project

facts in dispute cannot be resolved on the basis of the written record, *i.e.*, where written submissions do not provide an adequate basis for resolving disputes about material facts.

¹⁴ Under the IRS standards, executive compensation must fall within a range of competitive practices for similarly-situated organizations for functionally comparative positions.

capital expenses.¹⁵ Therefore, the Commission denies New England Advocates' request to set this matter for hearing.

20. We find ISO-NE's projected costs for professional and consulting fees and maintenance contracts to be just and reasonable. These projected costs for 2007 represent a nominal increase (less than two percent) over 2006 costs for the same fees and contracts,¹⁶ and there is strong stakeholder support for the overall 2007 Revenue Requirement.¹⁷ Furthermore, ISO-NE's Purchasing Policy is posted on its website. New England Advocates have not raised serious doubts about the prudence of ISO-NE's expenditures, but only assert that ISO-NE may not have obtained "the most efficient fee arrangement and contracts."¹⁸ Therefore we will not set this matter for hearing.

21. Finally, we reject New England Advocates' assertion that ISO-NE has not provided any support for its proposed staffing level increases. As ISO-NE explains in its October 13 Filing, the proposed staffing increases (13 new hires total) are primarily needed to help develop the FCM, a market mechanism for long-term resource adequacy. ISO-NE states that it needs an estimated 20.5 more employees to work on the FCM, and is bringing in 11 new hires for this work; the remaining 10 or 11 will be accounted for by drawing from existing staffing levels in other departments to help control costs. In *Devon Power LLC*, 115 FERC ¶ 61,340 (2006), the Commission found the FCM to be just and reasonable and consistent with the public interest. We find that ISO-NE's proposed staff increases -- adding only 13 new employees to an already existing staff of 420, and 11 of those 13 for work on a Commission-approved market mechanism --

¹⁵ ISO-NE October 31, 2006 Transmittal Letter, Docket No. ER07-115-000, at 13. No party has objected to any aspect of this filing.

¹⁶ ISO-NE October 31, 2006 Filing at Exhibit 3 RCL-5, Schedule 3.

¹⁷ *See supra* P 3.

¹⁸ *Cal. Indep. Sys. Operator Corp.*, 99 FERC ¶ 63,020, at 65,073-078 (2002), *aff. by Cal. Indep. Sys. Operator Corp.*, 103 FERC ¶ 61,114 (2003); *see also Minnesota Power & Light Co.*, Opinion No. 86, 11 FERC ¶ 61,312 (1980); *Kentucky Utilities Co.*, Opinion No. 380, 62 FERC ¶ 61,097, slip op. at 9-10 (1993); *Montaup Electric Co.*, 39 FERC ¶ 61,379, at 62,228-29 (1987); *Arizona Public Service Co.*, 27 FERC ¶ 61,185 (1984). These cases stand for the proposition that a party may only shift the burden to a utility (or ISO) to affirmatively establish that a questioned expenditure was prudent if that party can create serious doubt as to the prudence of the expenditure.

appear reasonable. Therefore, we will not set the matter of ISO-NE's proposed staff increases for hearing.

22. For these reasons, we will accept the proposed October 31 Filing, suspend it for a nominal period, to become effective January 1, 2007, subject to refund,¹⁹ and set the issue of ISO-NE's depreciation and amortization expenses for paper hearing.

The Commission orders:

(A) The October 31 Filing is hereby accepted for filing and suspended, to become effective January 1, 2007, subject to refund.

(B) The Commission directs ISO-NE to file a brief on the issue set for paper hearing by January 22, 2007. Parties who wish to file comments on ISO-NE's brief must do so by February 5, 2007. Parties who wish to file reply comments must do so by February 19, 2007. A party's presentation should separately state the facts and arguments advanced by the party and include any and all exhibits, affidavits, and/or prepared testimony. All materials must be verified and subscribed as set forth in 18 C.F.R. § 385.2005 (2006).

(C) Temporary waiver of the billing policy provision is granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

¹⁹ Despite ISO-NE's request to the contrary, we find that making the proposed filing subject to refund is appropriate since ISO-NE has the ability to change its billing prospectively. Furthermore, ISO-NE may change its "True Up" figures next year to account for any adjustments that result from the paper hearing's determination.