

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;  
Nora Mead Brownell, and Suedeen G. Kelly.

ISO New England Inc.

Docket No. ER06-94-000

## ORDER ACCEPTING TARIFF REVISIONS

(Issued December 30, 2005)

1. On October 31, 2005, ISO New England Inc. (ISO-NE) filed revised tariff sheets to collect its administrative costs for calendar year 2006 (October 31 Filing). In this order the Commission accepts ISO-NE's proposed tariff revisions for filing, to become effective January 1, 2006, as discussed below.

**Background**

2. In its October 31 Filing, ISO-NE proposed changes to Section IV.A of its Transmission, Markets and Services Tariff, FERC Electric Tariff No. 3 (Tariff) to collect its administrative costs for calendar year 2006 (2006 Revenue Requirement). ISO-NE states that its 2006 Revenue Requirement is approximately \$109.4 million. The proposed 2006 Revenue Requirement is composed of several elements: the 2006 "Core Operating Budget" (\$83.7 million);<sup>1</sup> "Debt Service" (\$30.3 million);<sup>2</sup> "True-Up Amounts" for 2004

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<sup>1</sup> ISO-NE notes that the 2006 Core Operating Budget reflects no increase from 2005 because \$5 million in forecasted expenditure increases, as compared with 2005 levels, are offset by approximately \$5 million in efficiencies and reductions as compared with 2005 levels. ISO-NE also notes that its 2006 Core Operating Budget is an estimation, and that it could be necessary for ISO-NE to seek additional funding through a supplemental Section 205 filing during 2006.

<sup>2</sup> ISO-NE reports that its Debt Service includes the following components: (1) recovery of depreciation; (2) amortization of Standard Market Design 1.0 expenditures put into service; (3) amortization of regulatory assets and interest expense necessary to repay principal and interest on Commission-approved capital borrowings; and (4) working capital borrowings.

and 2005 (\$2.2 million and \$2.3 million, respectively);<sup>3</sup> and the incremental amount of prior year depreciation not recoverable under the Tariff (approximately \$83,000). ISO-NE requests an effective date of January 1, 2006 for the proposed revisions.

3. In support of its filing, ISO-NE notes that its 2006 Operating Expense Budget was broadly endorsed by the NEPOOL Participants Committee, with 82.2 percent voting to support, and was approved by ISO-NE's Board of Directors.

### **Notice of Filings, Interventions, Comments, and Protests**

4. Notice of ISO-NE's October 31 Filing was published in the *Federal Register*, 70 Fed. Reg. 68,436 (2005), with protests due on or before November 21, 2005. Timely motions to intervene were filed by Black Oak Energy, LLC, EPIC Merchant Energy, LP, and SESCO Enterprises LLC; the Northeast Utilities Companies,<sup>4</sup> by their agent Northeast Utilities Service Company, and Select Energy, Inc.; and the New England Conference of Public Utilities Commissioners. The New England Power Pool Participants Committee filed a timely motion to intervene and comments in support of the October 31 Filing. Timely motions to intervene and protests were filed on behalf of: the Attorney General of the Commonwealth of Massachusetts (MA Attorney General); Richard Blumenthal, Attorney General for the State of Connecticut (CT Attorney General); and Massachusetts Municipal Wholesale Electric Company, Braintree Electric Light Department, Reading Municipal Light Department, and Tauton Municipal Lighting Plant (collectively, Massachusetts Public Systems). On December 6, 2005, ISO-NE submitted an answer to the protests. On December 21, 2005, the Massachusetts Public Systems responded to the answer.

### **Discussion**

#### **A. Procedural Matters**

5. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,<sup>5</sup> the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

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<sup>3</sup> 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.

<sup>4</sup> The Northeast Utilities Companies include: The Connecticut Light and Power Company, Western Massachusetts Electric Company, and Public Service Company of New Hampshire.

<sup>5</sup> 18 C.F.R. § 385.214 (2005).

6. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure<sup>6</sup> prohibits an answer to a protest or an answer unless otherwise permitted by the decisional authority. We will accept ISO-NE's answer and the Massachusetts Public Systems' response, as they provide information that assisted us in our decision-making process.

## **B. Analysis**

7. The CT Attorney General, MA Attorney General and Massachusetts Public Systems protest the rates proposed by ISO-NE as unjust and unreasonable for various reasons. As discussed in greater detail below, the Commission finds that the proposed rates are just and reasonable and accepts for filing ISO-NE's proposed tariff revisions, to become effective January 1, 2006.

### **1. "External Affairs" and "Corporate Communications" Expenses**

#### **a. Lobbying**

8. The Massachusetts Public Systems claim that ISO-NE's proposed rates fund activities that are not properly chargeable to ISO-NE's customers, including lobbying. The Massachusetts Public Systems argue that ISO-NE has lobbyists who are publicly registered with the U.S. Congress, Daryl Owen and Joseph F. Burke, Jr. (who, together, are compensated over \$240,000 per year for "lobbying" on a variety of issues). The Massachusetts Public Systems also provide public record lobbying reports for several entities that represent ISO-NE's interests before state legislative and regulatory officials, including The Karol Group, Inc. in Massachusetts, Roy & LeRoy in Connecticut, and Holland & Knight in Rhode Island. The Massachusetts Public Systems point out that ISO-NE's lobbyists have appeared before legislators over the past two years on subjects that include specific legislation (particular electricity-related bills pending before Congress), the establishment of a regional transmission organization for New England, ISO-NE's attempts to establish a Locational Installed Capacity market, and the implementation of Standard Market Design.

9. The Massachusetts Public Systems note that ISO-NE has justified these costs in the past by claiming that ISO-NE is merely providing information to state and federal officials regarding ISO-NE's mission and its current tasks. However, the Massachusetts Public Systems claim that ISO-NE is not simply providing facts to state and federal officials, but is asserting opinions and misrepresenting advocacy as education. The Massachusetts Public Systems further claim that if ISO-NE was only providing data and facts to state and federal officials, then this information could be provided publicly and without the involvement of federally-registered lobbyists. The Massachusetts Public

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<sup>6</sup> 18 C.F.R. § 385.213(a)(2) (2005).

Systems maintain that ISO-NE is instead providing its assessment of New England's needs and its policy positions. The Massachusetts Public Systems argue that ISO-NE's funding of this "lobbying" activity is in direct conflict with the Commission's regulations.<sup>7</sup> Consequently, the Massachusetts Public Systems ask the Commission to set this issue for a full evidentiary hearing, permitting discovery as to the nature and content of ISO-NE's past and expected future lobbying contacts with state and federal officials. The CT Attorney General also protests the inclusion of lobbying costs in the 2006 Revenue Requirement. The CT Attorney General requests that the Commission carefully review ISO-NE's reliance on professional and legal services, and seeks detailed reports that include all payments to outside experts and the benefits such payments accrue to the New England ratepayers.

10. The Massachusetts Public Systems also argue that ISO-NE's proposed rates are unjust and unreasonable because dissenting market participants cannot avoid compelled subsidization of expressive activities by ISO-NE. The Massachusetts Public Systems claim that ISO-NE is attempting to force its market participants to fund its lobbying and other expressive, ideological activities that have no connection to the administration of New England markets or to the planning and operation of the New England transmission grid. Specifically, the Massachusetts Public Systems protest the following line items: \$262,023 for Regulatory Affairs; \$1,108,250 for Public Information; and \$938,024 on Governmental Affairs.<sup>8</sup> The Massachusetts Public Systems claim that this forced subsidization of ISO-NE's expressive activities violates the First Amendment, which requires that dissenting participants be afforded specific protections against compelled subsidization of communicative activities. The Massachusetts Public Systems request specific protections, such as those cited in *Chicago Teachers Union No. 1 v. Hudson*, 475 U.S. 292, 305-09 (1986): (1) an escrow of that portion of the funds provided by

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<sup>7</sup> In support thereof, the Massachusetts Public Systems argue that 18 C.F.R. Part 101, Account No. 426.4 does not permit "expenditures for the purpose of influencing the decisions of public officials" to be passed through to customers.

<sup>8</sup> As described by ISO-NE: Regulatory Affairs "involves apprising the relevant regulatory agencies of the ISO's activities and operations, including system reliability, market operations, and matters pending before the Commission, as well as monitoring regulatory and legislative developments that could impact the ISO's operations"; Governmental Affairs "involves apprising state and federal non-regulatory officials of the same type of information"; and Public Information "involves the salary and overhead costs of apprising the general public, media, and Market Participants of the ISO's activities and operations, including work performed in the production of the ISO's annual report, public information brochures, maintenance of the web site, press releases and direct response to inquiries, and the Emergency Communications Program." Prepared Testimony of Robert C. Ludlow, ISO-NE Answer, Ex. 3 at 29.

dissenting participants, or similar arrangement sufficient to ensure funds obtained from the dissenting participant are not expended; (2) full and specific disclosure of the application of all funds derived from dissenting participants and of the disposition of funds derived from all participants; and (3) a mechanism for the prompt resolution of disputes by a neutral decision-maker.

11. In its answer, ISO-NE maintains that its 2006 budget for external affairs activities is just and reasonable. ISO-NE argues that, consistent with Commission policy, it may properly recover in its rates specified external affairs activities to educate and inform stakeholders, including public officials. ISO-NE also argues that the specific opt-out protections articulated by the Massachusetts Public Systems are “unworkable and inadvisable.”<sup>9</sup> ISO-NE further argues that the First Amendment does not bar ISO-NE’s collection of corporate communications funding from its customers.

12. In their response, the Massachusetts Public Systems argue that ISO-NE’s answer fails to address the substantive issues raised by their protest, expressing concerns about ISO-NE’s “characterization of what its lobbyists *might* do, without ever once attempting to meet the substance of what those lobbyist reports show that they *actually have* done.”<sup>10</sup>

13. As discussed below, the Commission finds that the types of expenses proposed by ISO-NE in the 2006 Revenue Requirement as Regulatory Affairs, Public Information, and Government Affairs activities in the 2006 Revenue Requirement may be recovered from ratepayers. We believe that the legislative monitoring and educational and informational communications, described in ISO-NE’s answer as those that will be funded by revenues collected through jurisdictional rates, are appropriate to support ISO-NE’s operations and are consistent with prior precedent. We further find that the amounts allocated to Regulatory Affairs, Public Information, Government Affairs and External Communications accounts have been justified by ISO-NE in its answer, and are reasonable for the proposed activities.

14. To be non-recoverable, the purpose of the communications must be like those listed in the text of Account 426.4:

expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation, or ordinances (either with respect to the possible adoption of new referenda, legislation or ordinances or repeal or modification of existing referenda, legislation or

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<sup>9</sup> ISO-NE Answer at 27.

<sup>10</sup> Massachusetts Public Systems Answer at 7 (emphasis in the original).

ordinances) or approval, modification, or revocation of franchises; or for the purpose of influencing the decisions of public officials . . .

While recovery of expenditures used to influence the decisions of public officials is generally not permitted, “expenditures ‘directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility’s existing or proposed operations’ are not considered to be civic, political, or related activities costs under the Commission’s accounting regulations.”<sup>11</sup>

15. We recognize that there is no bright-line between educational and informational activities and lobbying activities. We find, however, that the types of activities broadly described by ISO-NE are appropriately recovered from ratepayers. ISO-NE argues, in its answer, that its external affairs activities are in furtherance of its core objectives.<sup>12</sup> These activities include education and information activities such as: the provision of “information and briefings on real-time power system operations”; the provision of “information on the needs and performance of the power system and wholesale market”; the provision of “descriptions and explanations of pending and developing regulatory initiatives potentially affecting New England’s electricity consumers”; “briefings or other information as requested by legislators or regulators”; and the “monitor[ing of] legislative and regulatory developments.”<sup>13</sup> We have reviewed ISO-NE’s descriptions of these activities and find that they are in furtherance of ISO-NE’s mission and objectives. Because we find that ISO-NE’s proposed expenditures are directly related to its mission, objectives and, therefore, operations, we find that the activities described by ISO-NE – legislative monitoring and educational and informational communications – are appropriately recovered from ratepayers.

16. The fact that ISO-NE employs “lobbyists” that are registered with the U.S. Congress and state legislatures is not dispositive as to whether these individuals actually engage in unrecoverable “lobbying” activities. Under the Lobbying Disclosure Act of 1995, 2 U.S.C. § 1602 (1995), those engaged in “lobbying activities” including “lobbying contacts and efforts in support of such contacts, including preparation and planning activities, research and other background work that is intended, at the time it is performed, for use in contacts, and coordination with the lobbying activities of others,” 2 U.S.C. § 1602(7), must register as “lobbyists.” As the Massachusetts Public Systems

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<sup>11</sup> *ISO New England Inc.*, 111 FERC ¶ 61,096, at P 18 (2005), *pet. for review pending sub nom., Braintree Elec. Light Dept. v. FERC*, D.C. Cir. Case No. 05-1210 (citing 18 C.F.R. Part 101, Account No. 426.4 (2004)).

<sup>12</sup> See ISO-NE Tariff, section I.1.3, *cited in* ISO-NE Answer at 17-18.

<sup>13</sup> ISO-NE Answer at 20-21.

indicate, section 3(8)(B)(v) specifically exempts administrative requests if “the request does not include an attempt to influence a covered executive branch official or a covered legislative branch official.” We agree with ISO-NE, however, that providing information, education, or briefings to legislators or legislative staff could reasonably be construed as falling beyond the exemption. Therefore, we find that, notwithstanding the specific exemptions under the statute, it is reasonable for ISO-NE to conclude that its employees and agents should be required to comply with the registration and reporting requirements under federal and state lobbying laws (and thus, complete and file reports such as those proffered by the Massachusetts Public Systems), even if they do not engage in traditional lobbying activities.

17. The protesters ask the Commission for a hearing to obtain additional information as to the types of activities performed by ISO-NE’s “lobbyists.” We do not believe a hearing is warranted on this issue. For the reasons discussed above, we find that the proposal is just and reasonable. The additional information provided in ISO-NE’s answer provides sufficient justification for the costs proposed in the 2006 Revenue Requirement. We further note that ISO-NE’s accounting for actual legal expenses is subject to audit by the Commission pursuant to Federal Power Act section 301.<sup>14</sup>

**b. First Amendment**

18. The Massachusetts Public Systems also maintain that ISO-NE’s communications infringe on the First Amendment rights of its customers because its rate mechanisms provide no means for dissenting customers to avoid paying the cost of ideological or other activities that are not germane to ISO-NE’s activities. We disagree. First, we note that the Massachusetts Public Systems have opportunity to voice dissent through the ISO-NE stakeholder processes and at stakeholder meetings. We reject the Massachusetts Public Systems’ argument that its participation in ISO-NE is an example of “governmental imposition of group membership.”<sup>15</sup> Moreover, we find that the Commission’s acceptance of ISO-NE’s rates is not governmental action sufficient to trigger First Amendment protection. Allowing a regulated entity to recoup from ratepayers communicative costs does not convert these expenses into the Commission’s ordering this conduct, and does not constitute compelled speech. The Commission has found in the past that this “is consistent with the Supreme Court’s holding that when a state utility commission approves a request from a regulated entity, it does not transmute

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<sup>14</sup> 16 U.S.C. § 825 (2000).

<sup>15</sup> Massachusetts Public Systems Protest at 12.

that entities' [sic] action into state action."<sup>16</sup> For these reasons, the Commission's act of reviewing ISO-NE's proposed 2006 Revenue Requirement does not trigger the First Amendment protections sought by the Massachusetts Public Systems.

19. But even assuming that the Commission's actions in these circumstances constituted "governmental imposition of group membership," and assuming the 2006 Revenue Requirement was a "compelled subsidy," we are not persuaded by the Massachusetts Public Systems' argument that the First Amendment protections for dissenting participants apply here. "[S]uch a compelled subsidy is permissible when it is ancillary, or 'germane,' to a valid cooperative endeavor." *United States v. United Foods, Inc.*, 533 U.S. 405, 418 (2001) (J. Stevens, concurring), citing *Glickman v. Wileman Bros. & Elliot, Inc.*, 521 U.S. 457 (1997) and *Keller v. State Bar of Cal.*, 496 U.S. 1 (1990). Because ISO-NE has demonstrated that its external affairs and corporate communications activities are directly related to its mission and objectives, we believe that ISO-NE's actions are "germane" to its valid cooperative endeavors. Therefore, even if the Commission's actions constituted "governmental imposition of group membership" (which they do not), the "compelled subsidy" would not implicate the First Amendment protections requested by the Massachusetts Public Systems.

## 2. CEO Emerging Work Allowance and Operating Contingency

20. The Massachusetts Public Systems, the CT Attorney General and the MA Attorney General protest ISO-NE's attempt to recover \$1 million for its "Operating Contingency" and \$700,000 for "CEO Emerging Work Allowance" as unjust, unreasonable, and unsupported. The Massachusetts Public Systems claim that these items are duplicative on their face and should be disallowed or substantially reduced. The Massachusetts Public Systems also claim that neither item is necessary. ISO-NE attempts to justify the \$1 million Operating Contingency line item by claiming that that amount is necessary to handle unforeseen circumstances. However, the Massachusetts Public Systems claim that unforeseen circumstances are just as likely to reduce the overall revenue requirement as increase it. The Massachusetts Public Systems also claim that ISO-NE has no need for a contingency fund since it already has other sources of funds available to cover unforeseen expenses, including: (1) previous years' over-collections that have not yet been returned

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<sup>16</sup> *Williams Natural Gas Co.*, 77 FERC ¶ 61,277, at 62,185 (1996), *order on reh'g*, 80 FERC ¶ 61,158 (1997) (citing *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 357 (1974)); *see also Williston Basin Interstate Pipeline Company*, 76 FERC ¶ 61,066 (1996), *pet. for review granted in part, Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d 54 (D.C. Cir 1999), *order on remand*, 87 FERC ¶ 61,265 (1999); both substantively overturned on other grounds *Trunkline Gas Co.*, Opinion No. 441, 90 FERC ¶ 61,017, at 61,064 (2000) (finding charitable contributions are not operating expenses and bear no relationship to the necessary costs of providing utility service).

to customers; (2) the time value of those over-collections permanently retained by ISO-NE; (3) ISO-NE's access to a working-capital line of credit; and (4) ISO-NE's ability to propose a rate increase pursuant to section 205 of the Federal Power Act and seek expedited treatment and waiver of notice requirements. The Massachusetts Public Systems also argue that the existence of these funds available to ISO-NE should result in the October 31 Filing being treated as subject to refund.

21. We disagree with the Massachusetts Public Systems concerning the propriety of ISO-NE's recovery of a contingency. The Massachusetts Public Systems' protest of the Operating Contingency line item and the CEO Emerging Work Allowance line item stems from an apparent misunderstanding of ISO-NE's operating procedures.

22. A contingency line item in the October 31 Filing is needed because ISO-NE's proposed budget is an estimate. As ISO-NE explains in its answer, ISO-NE estimates as accurately as possible the costs of activities required during the upcoming year; however, due to costs which arise for which no funds were budgeted, and because ISO-NE is a non-profit entity with no holdings, ISO-NE must have some source of funds to cover unforeseen expenses throughout the year.

23. The total allocated cost of the combined line items is \$1,700,000 – \$1,000,000 for Operating Contingency and \$700,000 for CEO Emerging Work Allowance – or 1.6 percent of the total budget, which appears to be a reasonable amount of allocated contingency for a non-profit entity such as ISO-NE. We have accepted contingency line items of similar amounts for ISO-NE in the past.<sup>17</sup>

24. Further, it is reasonable for ISO-NE to expect unforeseen costs due to factors outside of its control. In fact, ISO-NE provides a list of possible activities that could result in unknowable costs in 2006 such as compliance with new NERC security standards, additional system planning resources, changes to ISO-NE's priorities as imposed by the Commission or the will of New England stakeholders, and additional litigation costs for potential proceedings before the Commission or elsewhere. The

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<sup>17</sup> See, e.g., "Contingency" (in the amount of \$1,700,000) in line item 13 of Exhibit 3, GWP-5, Schedule 1 RTO of ISO-NE's November 1, 2004 filing in Docket No. ER05-134-000; "Contingency" (in the amount of \$1,700,000) in line item 12 of Exhibit 3, GWP-5, Schedule 1 of ISO-NE's October 31, 2003 filing in Docket No. ER04-121-000; "Contingency" (in the amount of \$1,512,300) in line item 12 of Exhibit 5, GWP-5, Schedule 1 of ISO-NE's November 1, 2002 filing in Docket No. ER03-147-000; "Contingency" (in the amount of \$1,956,200) in line item 12 of Exhibit 4, PPM-5, Schedule 1 of ISO-NE's November 1, 2001 filing in Docket No. ER02-249-000; "Contingency" (in the amount of \$1,800,000) in line item 11 of Exhibit 4, PPM-5, Schedule 1 of ISO-NE's November 1, 2000 filing in Docket No. ER01-316-000.

Operating Contingency and CEO Emerging Work Allowance line items appropriately budget for these costs.

25. Importantly, ISO-NE's Capital Funding Tariff is designed to protect New England market participants from over-collection by ISO-NE. The True-Up mechanism forces ISO-NE to pay back the difference between the actual expenses incurred and the budgeted amount collected from market participants. Contrary to the Massachusetts Public Systems' contention, ISO-NE returns to customers all interest that it earns, including any excess revenue ultimately returned through the true-up provision. Each year, ISO-NE includes in its operating expense budget a credit for all such interest. Also, because ISO-NE refunds all over-recoveries and credits interest against its operating expenses, it is not necessary to make this filing subject to refund. If the funds are not needed as envisioned, they will be appropriately returned to ratepayers.

### **3. Indirect Supervision/Clerical Support**

26. The Massachusetts Public Systems further protest \$6.5 million for "Indirect Supervision/Clerical Support" as unsupported.

27. We will reject the Massachusetts Public Systems' protest. In its answer, ISO-NE explains that the amount budgeted for 2006 is about the same (slightly less) as the amount ISO-NE included in the 2005 Operating Expense Budget it filed last year. ISO-NE then provides detailed support for the costs in Attachment 2 of its answer. ISO-NE states that the costs include "non-discretionary" items to support business functions such as insurance, fees, office supplies and leases. Additionally, the Legal Department costs include a new legal secretary to provide additional departmental support in anticipation of ISO-NE's increased responsibilities as New England's Regional Transmission Organization and increased work load in light of the Energy Policy Act. The Commission finds that ISO-NE has provided adequate information on these costs.

### **4. Executive Compensation/Salary Increases and Salary Levels**

28. The MA Attorney General protests ISO-NE's claim that salaries increased by 4 percent, which includes a 3.5 percent merit increase and a 0.5 percent promotion increase. Based on its calculations, the MA Attorney General claims that this is in fact 6.5 percent over 2005 levels. The MA Attorney General also protests ISO-NE's proposed salary structure as unsupported and excessive, asserting that ISO-NE is proposing to pay an extremely high average of over \$127,000 per employee. The MA Attorney General also claims that ISO-NE provides no support for the claimed changes in the assumptions used to determine the pension and post retirement benefits other than pension expenses. The CT Attorney General encourages the Commission to avoid approving overly generous executive compensation packages or salary structures, as contained in the October 31 Filing.

29. In its answer, ISO-NE explains that the MA Attorney General's purported average salary figure is miscalculated because it is based on the line item "Salaries and Overheads." ISO-NE points out that "Salaries and Overheads" include not only salaries but also payroll taxes, benefits, benefits, and board fees. According to ISO-NE, the improper inclusion of these "Overhead" items in the calculation of the average ISO-NE employee salary results in an overestimation of approximately \$35,000.

30. ISO-NE further explains that it pays competitive wages to a highly specialized and educated workforce. Such a competitive salary, explains ISO-NE, tends to be higher than the salaries of less-skilled employees would be. Moreover, ISO-NE explains that it monitors compensation of its employees on an on-going basis through a variety of independent, third-party compensation surveys, as well as through custom job and market analysis of key jobs. ISO-NE also notes that this analysis of ISO-NE's compensation programs against appropriate benchmarks is done by nationally recognized compensation consulting firms. Finally, ISO-NE states that for ISO-NE executive compensation, ISO-NE must comply with IRS standards governing the reasonableness of compensation for executives of 501(c)(3) corporations. Specifically, ISO-NE's executive compensation must fall within a range of competitive practices for total compensation paid by similarly-situated organizations. ISO-NE notes that it has engaged a nationally recognized consulting firm to ensure compliance with this standard.

31. Finally, with regard to ISO-NE's pension and post-retirement benefits increases, ISO-NE argues that such increases are not the result of any change by ISO-NE in these benefits but are solely the result of the application of objective factors. Each year, in accordance with generally accepted accounting principles, ISO-NE applies a Discount Rate to estimate future pension and post-retirement accounts to determine the amount of the benefit obligation in future years. The Discount Rate for ISO-NE pension and post-retirement benefits has consistently been tied to Moody's AA bond rates, which was projected to be 5.25 percent, a decrease of 0.50 percent from the prior year. Since ISO-NE's pension and post-retirement benefits are funded solely by recovery of costs through Section IV.A of the Tariff, ISO-NE must recover a greater amount through its Section IV.A rates to maintain its pensions and post-retirement benefits from prior years.

32. The Commission finds ISO-NE's salary levels to be adequately supported and reasonable. We agree with ISO-NE that the MA Attorney General miscalculated ISO-NE's average salary level and the increases in ISO salaries for calendar year 2005 by aggregating salaries and overheads rather than considering salaries alone. Further, ISO-NE's on-going monitoring of the compensation of its employees and benchmarking by independent nationally recognized compensation consulting firms provides assurance that its salary levels are appropriate for its highly specialized work force.

33. We will also reject the MA Attorney General's claim that ISO-NE's pension and post-retirement benefits' increases are unsupported. ISO-NE explained in its answer that

its calculations are consistent with generally accepted accounting principles and with the calculation methodology it used in prior years. It also explained that the increase in these expenses was due to a change in an objective measure (*i.e.*, Moody's AA bond discount rate). We believe that ISO-NE's explanation is adequate.

## **5. Capitalization and Depreciation/Amortization of Labor Costs**

34. The MA Attorney General claims that ISO-NE failed to capitalize and depreciate/amortize its labor costs, including those associated with software work orders and other projects that have useful lives of more than one year.

35. The MA Attorney General also argues that ISO-NE failed to provide an itemization of the expected investment along with specific depreciation and amortization accrual rates applied to the investments, an error that results in a lack of support for ISO-NE's *pro forma* depreciation and amortization expenses for computer hardware, software, and other assets.

36. In its answer, ISO-NE argues that it did properly capitalize and depreciate/amortize its labor costs. ISO-NE points out that the MA Attorney General ignored other aspects of its filing and public, audited financial statements that show that ISO-NE has properly capitalized labor costs associated with capital projects, including those associated with software projects, that have useful lives of more than one year. For example, ISO-NE notes that its most recent Financial Statements for the year ended December 31, 2004 (dated March 22, 2005) reports that, consistent with the American Institute of Certified Public Accountants procedures contained in "Statement of Position 98-1" concerning "Accounting for the Costs of Computer Service Software," the "payroll and payroll-related costs (for example, costs of employee benefits) for employees who are directly associated with and who devote time to the internal-use computer software project, to the extent time spent directly on the project" are capitalized. ISO-NE explains that while such capitalized labor costs associated with software projects are not line-itemized, they are embedded in various projects. Additionally, ISO-NE's report of "Total Project Costs" – a line item included in each quarterly cost report filing made with the Commission – reflects internal and external labor costs.

37. ISO-NE also disagrees with the MA Attorney General's claim that ISO-NE has provided insufficient support for its *pro forma* depreciation and amortization expenses and that ISO-NE did not provide an itemization of expected investment. ISO-NE points out that the details of the allocation of depreciation and amortization expenses for 2006 are available in Exhibit 3, RCL-3 of Schedule 6 of the October 31 Filing. ISO-NE asserts that the level of detail provided by ISO-NE in the October 31 Filing is consistent with Commission regulations.

38. Based on the information provided in ISO-NE's answer, the Commission finds that ISO-NE has adequately supported its practices with respect to the capitalization of labor costs and has complied with the Commission's requirements for reporting depreciation and amortization expenses. Therefore, we will deny the MA Attorney General's protest with respect to these issues.

## 6. Schedule 2 Rate Design

39. Finally, the Massachusetts Public Systems protest ISO-NE's Schedule 2 rate design as unjust, unreasonable, and unduly discriminatory against all market participants that do not engage in virtual transactions. The Massachusetts Public Systems note that virtual transactions are expected to produce annual revenues in 2006 of just \$43,738. The Massachusetts Public Systems argue, therefore, that entities who engage solely in virtual trading – and are thus charged just a fraction of the \$43,738 – will pay just seven hundredths of the Schedule 2 revenue requirement.

40. Further, the Massachusetts Public Systems claim that ISO-NE has failed to provide any evidence regarding the virtual traders' current ability to afford higher rates than those that ISO-NE has proposed, nor has ISO-NE provided evidence that shows conclusive benefits accrued to New England markets through the participation of virtual traders. The Massachusetts Public Systems note that ISO-NE's "Update of the 2004 Report, 'Impact of Virtual Transactions On New England's Energy Market'" (2005 Virtual Transactions Report) refutes any attempt to correlate specific changes in ISO-NE's rate structures or cost allocations with either the levels of virtual trading participation or price convergence.

41. The Commission acknowledges that virtual traders are assessed only a small portion of the total Schedule 2 costs, as the Massachusetts Public Systems have pointed out. However, the Massachusetts Public Systems have not shown that the existing rate design, which has been determined by the Commission to be just and reasonable, has become unjust and unreasonable.<sup>18</sup> The Massachusetts Public Systems contend that ISO-NE failed to adduce substantial evidence to support ISO-NE's three-tiered rates;

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<sup>18</sup> In their response to ISO-NE's answer, the Massachusetts Public Systems note that "neither the ISO nor any other party . . . has attempted to defend that rate design as just, reasonable, and not unduly discriminatory." Massachusetts Public Systems Answer at 4. ISO-NE has not proposed a change from the rate design of the ISO-NE tariff currently on file with the Commission. We note that when the Commission has already found that the existing rate design is just and reasonable, ISO-NE would not be required to defend that finding in its administrative costs filing.

however, the burden is on Massachusetts Public Systems, as the party proposing a change to the existing rates, to show that the existing Schedule 2 rates for virtual transactions are not just and reasonable.<sup>19</sup>

42. The Commission initially adopted the three-tiered rate design for a nine-month period subject to further review once ISO-NE submitted its proposed rates for 2005.<sup>20</sup> ISO-NE filed the identical three-tiered rate design in its submission of proposed rates for 2005, and in its December 30, 2004 order,<sup>21</sup> the Commission accepted the three-tiered rate design as just and reasonable without placing a limit on the effective date.

43. The Commission has recently upheld its conclusion that virtual traders are beneficial to bid-based markets by helping to ensure that Day-Ahead and Real-Time prices do not diverge significantly, as well as by providing enhanced price discovery and liquidity to the market.<sup>22</sup> Further, in the October 31 Filing, ISO-NE's 2005 Virtual Transactions Report showed benefits enjoyed by all market participants as a result of the participation of virtual traders in 2005. Specifically, the presence of virtual transactions in the model<sup>23</sup> led to increased price convergence in 8 of 11 months and reduced market price of risk in 10 of 11 months. Further, the 2005 Virtual Transactions Report showed that the availability of virtual transactions during the report period continued to increase participation and, therefore, liquidity in the New England electricity market and expanded trading options. The 2005 Virtual Transactions Report also showed that virtual trading did not hamper price discovery, a desirable feature of ISO-NE's energy market. This evidence only buttresses the Commission's finding in the December 30, 2004 Order that the three-tiered rate design for Schedule 2 is just and reasonable.

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<sup>19</sup> See, e.g., *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 186-87 (D.C. Cir. 1986), citing *ANR Pipeline Co. v. FERC*, 771 F.2d 507, 514 (D.C. Cir. 1985) ("Thus, 'when the Commission imposes a change not proposed by the natural gas company – including *an alteration in an unchanged part of a proposed higher rate* – it must first find that the existing provision is unjust or unreasonable.") (emphasis in the original).

<sup>20</sup> *ISO New England, Inc.*, 108 FERC ¶ 61,138, at 61,808 (2004), *order on voluntary remand*, 113 FERC ¶ 61,055 (2005) (October 20, 2005 Order).

<sup>21</sup> *ISO New England, Inc.*, 109 FERC ¶ 61,383 (2004) (December 30, 2004 Order), *order on reh'g*, 111 FERC ¶ 61,096 (2005).

<sup>22</sup> October 20, 2005 Order, 113 FERC ¶ 61,055 at P 29-30.

<sup>23</sup> ISO-NE used the New England benchmark model which simulates the day-ahead and real-time prices that could have been observed with and without virtual transactions. By using the model, ISO-NE was able to directly compute the impact of virtual transactions on price convergence and the market price of risk.

44. As we found in the October 20, 2005 Order, virtual traders will provide these valuable market functions only when their participation in the market can be expected to be profitable, and that application of the same charges to virtual transactions and to physical transactions would seriously limit or eliminate this contribution by imposing significant costs on financial trades. Additionally, the Commission previously found that the existing rates charged virtual traders will allow them to participate in the market; in contrast, the Massachusetts Public Systems have not shown that higher rates would continue to allow such participation, or result in a greater contribution by virtual traders to Schedule 2 cost recovery. The Commission has also found that financial transactions are sufficiently different from physical transactions to warrant different rate treatment.<sup>24</sup>

45. The Commission stated in the October 20, 2005 Order:

While it might facially appear unfair to charge arbitrageurs a different, or lower, rate than other market participants who engage in physical transactions, in fact, the record in this case demonstrates that charging the same rate actually would reduce virtual trading, decrease arbitrageurs' contribution to fixed cost recovery, and increase the costs to the rehearing applicants and to other market participants.<sup>25</sup>

The Massachusetts Public Systems have not presented any evidence to the contrary. Neither have they proposed a rate that they believe would be just and reasonable; instead, the Massachusetts Public Systems only protest that the rate charged virtual traders is too low.

46. As the Commission found in the precursor order<sup>26</sup> to the October 20, 2005 Order, the per-bid charge for arbitrageurs should, in theory, be set at a rate that does not reduce the bidding of arbitrageurs to a level that decreases their overall contribution to cost recovery. Based on the record at hand and the lack of evidence to the contrary, the Commission continues to conclude that the existing rate for virtual trades is at an appropriate just and reasonable level.

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<sup>24</sup> October 20, 2005 Order, 113 FERC ¶ 61,055 at P 33.

<sup>25</sup> *Id.* at P 40.

<sup>26</sup> *ISO New England, Inc.*, 106 FERC ¶ 61,294 (2004), *order on reh'g*, 108 FERC ¶ 61,138 (2004).

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The Commission orders:

ISO-NE's proposed tariff revisions are hereby accepted for filing, as discussed in the body of this order, effective January 1, 2006.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.