

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. ER06-94-001

ORDER DENYING REHEARING

(Issued March 28, 2006)

1. On December 30, 2005, the Commission issued an order accepting for filing proposed tariff revisions submitted by ISO New England Inc. (ISO-NE) for the collection of its administrative costs for calendar year 2006.<sup>1</sup> In this order, the Commission denies rehearing of the December 30 Order.

**Background**

2. On October 31, 2005, 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 (October 31 Filing). In the December 30 Order, the Commission accepted ISO-NE's October 31 Filing. The Commission found that the proposed rates were just, reasonable, and not unduly discriminatory or preferential and accepted for filing ISO-NE's proposed tariff revisions, to become effective January 1, 2006, as requested.

3. Timely requests for rehearing of the December 30 Order were filed by: (1) Massachusetts Municipal Wholesale Electric Company, Braintree Electric Light Department, Reading Municipal Light Department, and Tauton Municipal Lighting Plant (the MA Public Systems); and (2) the Attorney General for the Commonwealth of Massachusetts (MA Attorney General). ISO-NE and EPIC Merchant Energy LP (EPIC) filed motions for leave to answer and answers to the rehearing requests.

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<sup>1</sup> *ISO New England Inc.*, 113 FERC ¶ 61,341 (2005) (December 30 Order).

## **Discussion**

### **A. Procedural Matters**

4. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2005), prohibits answers to requests for rehearing unless otherwise ordered by the decisional authority. We will accept the answers of ISO-NE and EPIC as they provided information that assisted us in our decision-making.

### **B. Analysis**

5. The MA Attorney General and MA Public Systems request rehearing of the December 30 Order, maintaining that the Commission erred in accepting ISO-NE's 2006 administrative cost filing as submitted. As discussed in greater detail below, the Commission denies rehearing.

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

##### **a. Concerns as to "Lobbying" Activities**

##### **i. The December 30 Order**

6. In response to ISO-NE's October 31 Filing, protesters claimed that ISO-NE's proposed rates fund activities that are not properly chargeable to ISO-NE's customers, including lobbying. In their protest, the MA Public Systems provided public record lobbying reports for several entities that represent ISO-NE's interests before Congress as well as state legislative and regulatory officials. The MA Public Systems pointed out that ISO-NE's lobbyists have appeared before legislators over the past two years on subjects that include specific legislation (particularly 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. The MA Public Systems argued that ISO-NE's funding of this "lobbying" activity is in direct conflict with the Commission's regulations.<sup>2</sup> Consequently, the MA Public Systems asked 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.

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<sup>2</sup> In support thereof, the MA Public Systems cited 18 C.F.R. Part 101, Account No. 426.4, which they assert does not permit "expenditures for the purpose of influencing the decisions of public officials" to be passed through to customers.

7. In its answer to protests, ISO-NE maintained that its 2006 budget for external affairs activities is just and reasonable. ISO-NE argued that, consistent with Commission policy, it may properly recover in its rates specified external affairs activities to educate and inform stakeholders and public officials. In their response to the ISO-NE answer, the MA Public Systems argued that ISO-NE's answer failed to address the substantive issues raised by their protest.

8. In the December 30 Order, the Commission found that the types of expenses proposed by ISO-NE in the October 31 Filing as Regulatory Affairs, Public Information, and Government Affairs activities may be recovered from ratepayers. The Commission found 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. The Commission further found that the amounts allocated to Regulatory Affairs, Public Information, Government Affairs and External Communications accounts were justified by ISO-NE, and are reasonable for the proposed activities.

9. The December 30 Order noted that, under the Commission's regulations, recovery of "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 [unrecoverable] civic, political, or related activities costs under the Commission's accounting regulations."<sup>3</sup> The December 30 Order found that because "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."<sup>4</sup>

**ii. Request for Rehearing**

10. In their petition for rehearing, the MA Public Systems argue that the Commission erred in accepting ISO-NE's unverified characterizations of the nature and scope of its prior and future lobbying activities over their proffer of evidence. The MA Public Systems maintain that, at a minimum, there are questions of fact concerning the accuracy of ISO-NE's descriptions of its external affairs activities and, therefore, whether the

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<sup>3</sup> December 30 Order at P 14 (citing *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>4</sup> December 30 Order at P 15.

recovery of these costs is inconsistent with the requirements of Account 426.4. The MA Public Systems ask the Commission to convene a full evidentiary hearing to investigate the types of “lobbying” contacts undertaken on behalf of ISO-NE, and determine whether such activities conform to the requirements of Account 426.4.

11. In its answer, ISO-NE argues that the evidence provided in the MA Public Systems’ protest is immaterial for this proceeding in that the October 31 Filing was prospective, *i.e.*, proposing rates for calendar year 2006 based on a forecasted budget for 2006. ISO-NE also argues that the MA Public Systems do not “seek rehearing of the Commission’s determination that the ISO’s planned activities for 2006 are not properly recoverable from Customers. Instead, the rehearing request addresses past periods.”<sup>5</sup>

### iii. Commission Determination

12. We deny the MA Public Systems’ request for rehearing on this issue. As stated in the December 30 Order, and upon further review of the evidence in the record, we find that ISO-NE has adequately demonstrated that the proposed expenses will be used to fund educational and informational activities that are in furtherance of ISO-NE’s core objectives.<sup>6</sup>

13. We have held that the portion of expenses “used for lobbying activities may not, under any circumstances, be included in the utility’s cost of service.”<sup>7</sup> However, as stated in the December 30 Order, we are persuaded by ISO-NE’s explanation that corporate communications underlying these costs will be used for educational and informational, rather than influential, purposes. There is a broad range of communications that are recoverable in jurisdictional rates, including those described in ISO-NE’s filings, *i.e.*, “information and briefings on real-time power system operations”; “information on the needs and performance of the power system and wholesale market”; “descriptions and explanations of pending and developing regulatory initiatives

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<sup>5</sup> ISO-NE Answer to Petitions for Rehearing at 14.

<sup>6</sup> In regard to ISO-NE’s argument that the MA Public Systems fail to seek rehearing of the Commission’s approval of the appropriateness of the activities proposed by ISO-NE for 2006, we find that the evidence filed by the MA Public Systems, although reflective of past periods, is relevant to the types of activities that will be undertaken under the 2006 administrative cost filing, and therefore, relevant to this proceeding. However, as discussed above, we deny the MA Public Systems’ request for rehearing on this issue on the merits.

<sup>7</sup> *Delmarva Power & Light Co.*, 58 FERC ¶ 61,169 at 61,509, *order on reh’g*, 58 FERC ¶ 61,282, *further order on reh’g*, 59 FERC ¶ 61,169 (1992).

potentially affecting New England's electricity consumers";<sup>8</sup> "briefings or other information as requested by legislators or regulators";<sup>9</sup> and "monitor[ing of] legislative and regulatory developments."<sup>10</sup> These forms of communications should not be foreclosed to ISO-NE. RTOs/ISOs must not be hamstrung in their ability to communicate with the Commission, members of Congress, state officials, or the public concerning the RTO/ISO's missions and functions.

14. The evidence provided in the MA Public Systems' protest does not refute the credibility of ISO-NE's characterization of these expenses because, as discussed above, ISO-NE has adequately indicated the types of corporate communications that it will make with funds recovered from ratepayers, and these activities are distinct from those includable in Account 426.4. Accordingly, that evidence does not raise issues of material fact as to whether ISO-NE will account for such activities, and therefore we deny the request for a hearing on this matter.

15. We further note that, as indicated in the December 30 Order, ISO-NE's accounting for actual expenses is subject to audit by the Commission pursuant to Federal Power Act (FPA) section 301.<sup>11</sup> As a result, the Commission can investigate and address any impropriety that may develop.<sup>12</sup>

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<sup>8</sup> December 30 Order at P 15 (citing ISO-NE Answer at 20-21).

<sup>9</sup> December 30 Order at P 15 (citing ISO-NE Answer at 20-21); *see also Alaskan Northwest Natural Gas Transp. Co.*, 19 FERC ¶ 61,218 at 61,428 (1982), *aff'd in relevant part sub. nom., Northern Border Pipeline Co.*, 23 FERC ¶ 61,213 (1983) (noting that "the Commission has been advised by the Office of the Chief Accountant that the amounts its auditors have classified as 'lobbying activities' do not include costs relating to responses to requests received from legislators or regulatory groups with oversight responsibilities for the project.").

<sup>10</sup> December 30 Order at P 15 (citing ISO-NE Answer at 20-21); *see also Williams Natural Gas Co.*, 73 FERC ¶ 63,015 at 65,072 (1995) (J. Bullock), *order on initial decision*, 77 FERC ¶ 61,277 (1996), *order on reh'g*, 80 FERC ¶ 61,158 (1997) (finding that "time being spent on monitoring, reading and assessing the impact of regulatory and legislative developments in the natural gas industry ... are related to ... regulatory activities and thus an appropriate utility-related expenditure for inclusion in ... rates.").

<sup>11</sup> December 30 Order at P 17 (citing 16 U.S.C. § 825 (2000)).

<sup>12</sup> We also note that, as part of ISO-NE's non-profit status, ISO-NE is precluded by its Certificate of Incorporation from engaging (substantially) in lobbying activities. The Certificate of Incorporation states, in relevant part:

A substantial part of the activities of the Corporation shall not

(continued...)

**b. Concerns as to First Amendment Protections**

**i. The December 30 Order**

16. In its protest of the October 31 Filing, the MA 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 MA Public Systems claimed 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 in violation the First Amendment, which requires that dissenting participants be afforded specific protections against compelled subsidization of communicative activities. The MA Public Systems requested specific protections such as those cited in *Chicago Teachers Union No. 1 v. Hudson*.<sup>13</sup>

17. The December 30 Order rejected these concerns. First, the Commission noted that the MA Public Systems have an opportunity to voice dissent through the ISO-NE stakeholder processes and at stakeholder meetings. The Commission also rejected the MA Public Systems' argument that its participation in ISO-NE is an example of "governmental imposition of group membership."<sup>14</sup> The December 30 Order also found that the Commission's acceptance of ISO-NE's rates is not governmental action sufficient to trigger First Amendment protections. The December 30 Order further found that, because ISO-NE had demonstrated that its external affairs and corporate communications activities are directly related to its mission and objectives, even if the

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consist of carrying on propaganda or attempting to influence legislation except as permitted by the [Internal Revenue Code of 1986, as amended (Code)], including but not limited to Section 501(h) of the Code.

ISO New England Inc., *Second Restated Certificate of Incorporation* § 4(c) (Apr. 27, 2005), available at [http://www.iso-ne.com/aboutiso/corp\\_gov/cert\\_inc/index.html](http://www.iso-ne.com/aboutiso/corp_gov/cert_inc/index.html).

<sup>13</sup> 475 U.S. 292 (1986) (*Hudson*). As set forth in *Hudson*, protections for dissenting participants include: (1) an escrow of that portion of the funds provided by 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. *Id.* at 305-09.

<sup>14</sup> MA Public Systems Protest at 12.

Commission's actions constituted "governmental imposition of group membership," the "compelled subsidy" would not implicate the First Amendment protections requested by the MA Public Systems.<sup>15</sup>

**ii. Request for Rehearing**

18. In their petition for rehearing, the MA Public Systems maintain that the Commission erred in refusing to require protective conditions against compelled subsidization of ISO-NE lobbying and litigation activities. First, the MA Public Systems reassert that their participation as rate-paying customers under the ISO-NE tariff is a "state imposed obligation which makes group membership less than voluntary."<sup>16</sup> The MA Public Systems maintain that they never agreed with "[t]he formation of RTO New England and evisceration of the preceding NEPOOL arrangements."<sup>17</sup> The MA Public Systems also note that there are no suppliers of regional transmission service or control area services in New England other than ISO-NE.

19. Second, the MA Public Systems argue that "the Commission's promotion and imposition of ISO-NE as a Regional Transmission Organization, combined with its repeated annual approval of ISO-NE budgetary revenue requirements that incorporate funding for lobbying and litigation to which timely objection is consistently made by those compelled to pay the resulting rates and charges" constitutes government action to the extent necessary to implicate First Amendment protections for dissenting participants.<sup>18</sup> The MA Public System argue that the Commission's orders requiring customers to purchase services from ISO-NE and review of annual rate filings make their participation in ISO-NE "fairly attributable" to the Commission.<sup>19</sup>

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<sup>15</sup> See December 30 Order at P 19. The Supreme Court's First Amendment precedent establishes that 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) (*United Foods*), citing *Glickman v. Wileman Bros. & Elliot, Inc.*, 521 U.S. 457 (1997) and *Keller v. State Bar of Cal.*, 496 U.S. 1 (1990).

<sup>16</sup> MA Public Systems Petition for Rehearing at 9-10 (citing *United Foods*, 533 U.S. at 405).

<sup>17</sup> *Id.* at 9.

<sup>18</sup> *Id.* at 2.

<sup>19</sup> *Id.* at 10-12 (citing *Lugar v. Edmonson Oil Co.*, 457 U.S. 922, 939 (1982) (*Lugar*); *Pacific Gas & Elec. Co. v. Pub. Utils. Comm'n*, 475 U.S. 1, 12-16, *pet. for reh'g denied*, 475 U.S. 1133 (1986) (*Pacific Gas*); *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 396-400 (1995) (*Lebron*); *Hurley v. Irish-American Gay, Lesbian and Bisexual*

(continued...)

20. Finally, the MA Public Systems argue that the Commission erred in finding that ISO-NE's actions are germane to its valid cooperative endeavors.<sup>20</sup> The MA Public Systems argue that the Commission fails to specify the types of "endeavors" to which ISO-NE's corporate communications and external affairs activities are germane. The MA Public Systems argue that this is particularly problematic given the Commission's failure to grant a hearing on the factual inquiry of the nature and scope of ISO-NE's "lobbying" activity, as discussed above. The MA Public Systems state that "it is not for the Commission to decide in the first instance (on a summary basis) that speech is 'germane' and to use that determination as a basis for finding that *Hudson*-type conditions are unnecessary," arguing that "[t]he Commission may not deprive customers forced to fund ISO's expressive activities of the information necessary for *them* to determine whether the ISO has impinged their First Amendment rights."<sup>21</sup>

21. In its answer, ISO-NE explains that the MA Public Systems fail to distinguish precedent that a regulatory agency's authorization and approval of a practice by a non-governmental public utility does not transform that practice into state action. ISO-NE maintains that the December 30 Filing appropriately found the proposed activities to be consistent with ISO-NE's ratemaking policies and germane to its mission and objectives and, therefore, do not require the protections sought by the MA Public Systems. ISO-NE again asserts that the MA Public Systems fail to seek rehearing of the Commission's approval of the appropriateness of the activities proposed by ISO-NE for 2006, but instead addresses past periods.

### iii. Commission Determination

22. The Commission will deny the MA Public Systems' request for rehearing on this issue. We reaffirm the findings of the December 30 Order that the Commission's acceptance of ISO-NE's rates is not "state action" warranting First Amendment protections.

23. The line of First Amendment cases cited by the MA Public Systems does not control here.<sup>22</sup> There is no "pervasive entwinement of public institutions and public

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*Group of Boston*, 515 U.S. 557, 573 (1995) (*Hurley*)).

<sup>20</sup> See *supra* note 15. As discussed above, in *United Foods*, the Supreme Court recognized that a compelled subsidy is permissible when it is ancillary or germane to a valid cooperative endeavor.

<sup>21</sup> *Id.* at 14 (emphasis in the original).

<sup>22</sup> We also note that the Commission's recent reference to *United Foods* in *PJM Interconnection L.L.C.*, 113 FERC ¶ 61,292, at P 40 n.13 (2005) (*PJM*), is not dispositive (continued...)

officials in [ISO-NE's] composition and workings.”<sup>23</sup> The Commission's role in the development of ISO-NE does not rise to the level of “entwinement” discussed in judicial precedent.<sup>24</sup>

24. “[S]tate action may be found if, though only if, there is such a ‘close nexus between the State and the challenged action’ that seemingly private behavior ‘may be fairly treated as that of the State itself.’”<sup>25</sup> The MA Public Systems argue that the Commission's promotion of RTOs, its acceptance of New England arrangements that require association with ISO-NE, and its review of ISO-NE's annual filings are evidence that ISO-NE's actions are fairly attributable to the Commission.<sup>26</sup> While government “coercion” or “encouragement” may, under some circumstances, justify characterizing an ostensibly private action as public instead (for purposes of the Federal Constitution's Fourteenth Amendment), we find that the Commission's encouragement of RTOs/ISOs

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of the issues arising in this proceeding. We reject the MA Public Systems' characterization that the discussion in *PJM* meant the Commission “acknowledg[ed] that RTOs were governmentally-mandated associations whose dissenting customers are (at least theoretically) entitled to such protections.” MA Public Systems Petition for Rehearing at 8-9. We note that the Commission's discussion in *PJM* describes the Commission's position that *United Foods* was not relevant in that proceeding. Footnote 13 stands for the proposition that even if the Commission's actions constituted a compelled subsidy, such subsidy is permitted where ancillary or germane to a valid cooperative endeavor. *See also* December 30 Order at P 19.

<sup>23</sup> *Brentwood Acad. v. Tenn. Secondary Sch. Athletic Ass'n*, 531 U.S. 288, 298 (2001) (*Brentwood Academy*).

<sup>24</sup> *See Id.* at 298-303 (finding the association's nominally private character was overborne by a pervasive entwinement of state school officials in the association's structure); *Lebron*, 513 U.S. at 396-400 (finding entwinement in the instance of “[g]overnment-created and -controlled corporations”).

<sup>25</sup> *Brentwood Academy*, 531 U.S. at 295 (citing *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 351 (1974) (*Jackson*)). We also note that the required nexus may be present if the private entity has exercised powers that are “traditionally the exclusive prerogative of the State.” *Jackson*, 419 U.S. at 353 (describing the “public function” test); *see also Flagg Bros., Inc. v. Brooks*, 436 U.S. 149, 157-64 (1978) (*Flagg Bros.*). Such circumstances are not present here. *See Jackson*, 419 U.S. at 352-53 (expressly declining to expand the “public function” doctrine to the supplying of utility services).

<sup>26</sup> MA Public Systems Petition for Rehearing at 10-12.

in the New England region and role in reviewing the justness and reasonableness of ISO-NE's rates does not constitute of "coercive power" or "significant encouragement" described in court precedent.<sup>27</sup>

25. We disagree that the Supreme Court's findings in *Hurley*<sup>28</sup> and *Pacific Gas*<sup>29</sup> control here. Both *Hurley* and *Pacific Gas* present cases in which the relevant state entity took affirmative actions to dictate the message that a private entity was required to say. In this case, the Commission is not dictating anything; ISO-NE will independently make decisions about whether to speak, and if it speaks, ISO-NE will determine the content of its speech. There is no state action under the present circumstances because the Commission is not responsible for the content of ISO-NE's speech.

26. We find the present circumstances to be most similar to those in *Jackson v. Metropolitan Edison Co.*<sup>30</sup> In that case, a utility consumer sought the protections of constitutional due process after her utility company terminated her electricity for non-payment. The consumer argued that the utility's business practices constituted state action on the basis that the privately owned and operated utility was subject to extensive state regulation. The Supreme Court disagreed, finding that the regulatory agency's authorization and approval of a practice by a non-governmental public utility does not transform that practice into state action. That finding applies directly to the present circumstances. The Supreme Court explicitly rejected the argument "that 'state action' is present because of the monopoly status allegedly conferred upon [the utility] by the [state commission]," finding that presuming such monopoly relationship existed, "this fact is not determinative" in considering whether state action existed.<sup>31</sup> The relationship

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<sup>27</sup> See *Blum v. Yaretsky*, 457 U.S. 991, 1004 (1982) (*Blum*); *Flagg Bros.*, 436 U.S. at 164-66.

<sup>28</sup> *Hurley*, 515 U.S. at 566 (a "compelled association" case where state action issue not raised before the Supreme Court).

<sup>29</sup> *Pacific Gas*, 475 U.S. at 12-14 (a "compelled access" case where state action was not an issue).

<sup>30</sup> 419 U.S. 345.

<sup>31</sup> *Id.* at 351-52. "In cases involving extensive state regulation of private activity, [the courts] have consistently held that 'the mere fact that a business is subject to state regulation does not by itself convert its action into that of the State for purposes of the Fourteenth Amendment.'" *Am. Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 52 (1999) (*American Mfrs.*) (citing *Jackson*, 419 U.S. at 350); see also *Blum*, 457 U.S. at 1004-05 ("Mere approval of or acquiescence in the initiatives of a private party is not sufficient to justify holding the state responsible for those initiatives under the terms of the Fourteenth Amendment.").

between the utility and state commission in *Jackson* is directly comparable to that between ISO-NE and the Commission.<sup>32</sup>

27. The MA Public Systems also proffer as part of their evidence that “[t]hus far, the Commission has consistently approved ISO-NE’s annual rate filings over the specific objections of intervening ISO-NE customers that those rates encompass the recovery of lobbying and litigation costs to which the customers object.”<sup>33</sup> We note that the fact that the Commission has approved ISO-NE’s administrative costs as just and reasonable in the past does not make, as the MA Public Systems imply, all of ISO-NE’s activities fairly attributable to the Commission.

28. In short, the Commission’s prior actions regarding RTO/ISO activity in the New England region and role in evaluating whether ISO-NE’s rates are just and reasonable is insufficient to rise to the level of making ISO-NE’s activities attributable to the Commission.

29. Further, as we found in the December 30 Order, because ISO-NE demonstrates that it will conduct its external affairs and corporate communications activities so as to directly relate them to its mission and objectives, even if the Commission’s actions constituted “governmental imposition of group membership,” the “compelled subsidy” would not implicate the First Amendment protections requested by the MA Public Systems. Consistent with our findings in section B.1.a.iii, *supra*, the types of activities proposed by ISO-NE for which its corporate communications expenses are to be spent are “ancillary, or ‘germane,’ to a valid cooperative endeavor,”<sup>34</sup> *i.e.*, ISO-NE’s missions and objectives, and therefore would not raise the First Amendment protections sought by the MA Public Systems.

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<sup>32</sup> See also *Jackson*, 419 U.S. at 358 (citing *Moose Lodge No. 107 v. Irvis*, 407 U.S. 163, 176-77 (1972)) (“However detailed this type of regulation may be in some particulars, it cannot be said to in any way foster or encourage racial discrimination. Nor can it be said to make the State in any realistic sense a partner or even a joint venturer in the club’s enterprise.”); *Blum*, 457 U.S. at 1008; *American Mfrs.*, 526 U.S. at 52.

<sup>33</sup> MA Public Systems Petition for Rehearing at 11.

<sup>34</sup> *United Foods*, 533 U.S. at 418 (J. Stevens, concurring); see also December 30 Order at P 19.

## **2. CEO Emerging Work Allowance and Operating Contingency**

### **a. The December 30 Order**

30. Several entities protested ISO-NE's attempt in the October 31 Filing to recover its "Operating Contingency" and "CEO Emerging Work Allowance" expenses as unjust, unreasonable, and unsupported. In the December 30 Order, the Commission disagreed with the protesters and permitted ISO-NE's recovery of these contingency expenses. The December 30 Order concluded that the total allocated cost of the combined line items appeared to be a reasonable amount of allocated contingency for a non-profit entity such as ISO-NE. The December 30 Order also concluded it is reasonable for ISO-NE to expect unforeseen costs due to factors outside of its control.

### **b. Request for Rehearing**

31. The MA Attorney General requests rehearing as to the Commission's acceptance of these expenses as part of the cost of service. The MA Attorney General argues that the Commission did not consider the possibility of lower cost alternatives available to ISO-NE and did not provide reasons why ISO-NE cannot use its lines of credit to cover, on a temporary basis, any costs that are over budget. The MA Attorney General also notes that ISO-NE has at its disposal lines of credit from which it can make short-term borrowing.

32. In its answer, ISO-NE argues that the Commission need not consider other allegedly lower-cost alternatives if the filing utility's proposal is just and reasonable. ISO-NE also states that the lines of credit referenced by the MA Attorney General were designed to be used for working capital/daily operational needs, not to cover "over budget" expenditures and that it uses its lines of credit, only as necessary, to fund on-going operating needs within its existing budget on a monthly basis. ISO-NE also notes it returns any contingency fund revenues not spent, including interest, to customers through the True-Up mechanism.

### **c. Commission Determination**

33. The Commission will deny the MA Attorney General's request for rehearing on this matter. Under the FPA, if we find that ISO-NE has successfully supported the justness and reasonableness of its "Operating Contingency" and "CEO Emerging Work Allowance" expenses, we must approve it. We cannot, under those circumstances,

consider alternatives to what is proposed by ISO-NE.<sup>35</sup> We reiterate that the December 30 Order's conclusion that the total allocated cost of the combined line items appear to be a reasonable amount of allocated contingency for a non-profit entity such as ISO-NE and that it is reasonable for ISO-NE to expect unforeseen costs due to factors outside of its control. We also find that additional protection for customers exists in the form of the ISO-NE True-Up mechanism, which ensures that ISO-NE will return any unspent contingency fund revenues with interest.

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

#### **a. The December 30 Order**

34. In response to ISO-NE's October 31 Filing, the MA Attorney General, among others, protested ISO-NE's salary increases and salary levels as unsupported and excessive. The MA Attorney General also claimed 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.

35. In the December 30 Order, the Commission found that ISO-NE's salary levels were adequately supported and reasonable. The Commission agreed 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, the Commission found that 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.

36. The December 30 Order also rejected the MA Attorney General's claim that ISO-NE's pension and post-retirement benefits increases are unsupported, finding adequate ISO-NE's explanation that: (a) its calculations are consistent with generally accepted accounting principles and with the calculation methodology it used in prior years; and (b) the increase in these expenses was due to a change in an objective measure (*i.e.*, Moody's Aa bond discount rate).

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<sup>35</sup> See, e.g., *Pub. Serv. Co. of New Mexico v. FERC*, 832 F.2d 1201, 1211 (10th Cir. 1987); *Cities of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir.), *cert. denied*, 469 U.S. 917 (1984).

**b. Request for Rehearing**

37. The MA Attorney General requests rehearing of the Commission's acceptance of ISO-NE's executive compensation/salary increases and salary levels. The MA Attorney General maintains that the Commission erred in relying on ISO-NE's unsworn and incorrect calculations of the employee compensation. The MA Attorney General maintains that, including overtime and bonuses, ISO-NE's employees earn an average annual income of \$101,168. The MA Attorney General also notes that ISO-NE has failed to provide any evidence to support its position that paying such an amount is reasonable.

38. The MA Attorney General also argues that the Commission failed to consider fully the MA Attorney General's claim that employee compensation increased by 6.5 percent over 2005 levels. The MA Attorney General maintains that ISO-NE failed to explain its proposal that the employee "overhead" expenses should be increasing at a rate that is more than four times inflation.

39. The MA Attorney General also maintains that the Commission relied on unsupported and inappropriate data in ISO-NE's answer regarding the decrease in the discount rate that was the basis for the increase in the pension and post-retirement benefits. The MA Attorney General argues that ISO-NE's statement that the increase in the pension and post-retirement benefits was necessary because of a decrease in the discount rate from 5.75 percent to 5.25 percent is wrong. Citing the *Hewitt Global Report* for December 2005, the MA Attorney General maintains that the range of retirement plan discount rates for the United States at the end of 2005 was 5.5 percent to 6.0 percent. Based on this evidence, the MA Attorney General argues that ISO-NE's 2006 discount rate is an outlier.

40. In its answer, ISO-NE maintains that ISO-NE's salaries are just and reasonable given its need for highly skilled personnel, its limited ability to offer benefits that for-profit entities may offer, and its reliance on overtime/on-call pay more than the average company. ISO-NE also notes that this concern is in fact a new claim raised on rehearing because the MA Attorney General changed the argument raised in its original protest, having lowered on rehearing its estimation of ISO-NE's alleged average salary.

41. ISO-NE also argues that the discount rate used to estimate future pension and post-retirement amounts was reasonable and made in good faith at the time the estimate was developed. ISO-NE argues that it has consistently tied its discount rate to the Moody's Aa bond interest rate that is available when developing the forecasted budget, and that the information from Moody's constitutes a reputable, acceptable, and objective source. ISO-NE also notes that the December 2005 Hewitt Report cited by the MA Attorney General was not available at the time of the October 31 Filing. Instead ISO-NE

states that the August 2005 Hewitt Report, which was available for comparison, shows the expected range of discount rates to be 5.00 percent to 5.25 percent, consistent with ISO-NE's use of a 5.25 percent discount rate.

**c. Commission Determination**

42. We will deny the MA Attorney General's request for rehearing on this matter. As stated in the December 30 Order, we find that ISO-NE has adequately supported the reasonableness of its executive compensation and salary levels. Given ISO-NE's need for highly skilled labor, the compensation in the October 31 Filing is appropriate. As noted in the December 30 Order, "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."<sup>36</sup> We also reaffirm our finding that the discount rate ISO-NE used to estimate future pension and post-retirement amounts was reasonable at the time of filing for the reasons given by ISO-NE. The MA Attorney General has not shown otherwise.

**4. Capitalization and Depreciation/Amortization of Labor Costs**

**a. The December 30 Order**

43. The MA Attorney General also protested ISO-NE's October 31 Filing on the basis that ISO-NE failed to provide sufficient support for the capitalization and depreciation/amortization of its labor costs.

44. The December 30 Order found that ISO-NE 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.

**b. Request for Rehearing**

45. The MA Attorney General requests rehearing of the December 30 Order arguing that the Commission erred by not requiring more detailed information from ISO-NE as to the amounts of labor costs ISO-NE capitalized in its cost of service and depreciation and amortization expenses. The MA Attorney General questions the Commission's reliance on ISO-NE's claim that because certain of its past financial statements were found to conform with Generally Accepted Accounting Principles (GAAP), all of the *pro forma* cost of service conforms with GAAP. The MA Attorney General argues that deviations

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<sup>36</sup> December 30 Order at P 32.

from GAAP and/or regulatory accounting requirements have historically been a fundamental problem with the *pro forma* adjustments made to historical test year amounts in utility filings made in ratemaking proceedings. The MA Attorney General asks the Commission to require ISO-NE to provide further information to determine whether portions of the *pro forma* labor cost adjustments were in fact capitalized and whether they were capitalized in the correct amounts.

46. In its answer, ISO-NE argues that the October 31 Filing provides sufficient detail of its depreciation and amortization and is consistent with prior administrative cost filings approved by the Commission. ISO-NE maintains that any problems incurred with *other* public utilities are not relevant to this proceeding.

**c. Commission Determination**

47. We will deny the MA Attorney General's request for rehearing on this matter. ISO-NE has adequately supported the nature of these costs, and in the December 30 Order, we accepted ISO-NE's justification. Nothing in the MA Attorney General's petition convinces us otherwise.

**5. Depreciation and Amortization Expenses**

**a. The December 30 Order**

48. In its protest to the October 31 Filing, the MA Attorney General argued that ISO-NE failed to provide an itemization of the expected investment along with specific depreciation and amortization accrual rates applied to 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.

49. The December 30 Order rejected the MA Attorney General's argument and found that ISO-NE provided sufficient detail of the allocation of depreciation and amortization expenses for 2006 in Exhibit 3, RCL-3 of Schedule 6 of the October 31 Filing.

**b. Request for Rehearing**

50. In its petition for rehearing, the MA Attorney General argues that the Commission erred in relying on ISO-NE's assertions that the October 31 Filing includes sufficient detail to analyze the allocation of depreciation and amortization expenses for 2006. The MA Attorney notes in particular that the filing fails to describe ISO-NE's hardware and software investments and expected useful life and that, without this information, current ratepayers may be unfairly subsidizing future ratepayers.

51. In its answer, ISO-NE asserts that it did provide sufficient detail to support the depreciation and amortization expenses of its investments in the October 31 Filing and that level of detail is consistent with Commission precedent. ISO-NE also maintains that the filing discusses the useful lives by class of asset that it continues to use on a going-forward basis and that it would be impractical for ISO-NE to list in its filing every capitalized asset on its books with the applicable useful life.

**c. Commission Determination**

52. We will deny the MA Attorney General's request for rehearing on this matter. ISO-NE has adequately supported the nature of these costs, and in the December 30 Order, we accepted ISO-NE's justification. We find that the level of detail provided by ISO-NE as to the useful lives by class of asset that it continues to use on a going-forward basis is sufficient to support this finding.

**6. Schedule 2 Rate Design**

**a. The December 30 Order**

53. Finally, the MA Public Systems protested ISO-NE's Schedule 2 rate design, as set forth in the October 31 Filing, as unjust, unreasonable, and unduly discriminatory against all market participants that do not engage in virtual transactions. The MA Public Systems claimed that ISO-NE 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.

54. The December 30 Order acknowledged that virtual traders are assessed only a small portion of the total Schedule 2 costs. The December 30 Order also found that the burden is on MA 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. Further, the December 30 Order found that based on the record at hand, the lack of evidence to the contrary, and ISO-NE's 2005 Virtual Transactions Report, that the three-tiered rate design for Schedule 2, as approved in prior orders<sup>37</sup> is just and reasonable.

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<sup>37</sup> See *ISO New England, Inc.*, 108 FERC ¶ 61,138, at 61,808 (2004), *order on voluntary remand*, 113 FERC ¶ 61,055 (2005); *ISO New England, Inc.*, 109 FERC ¶ 61,383 (2004), *order on reh'g*, 111 FERC ¶ 61,096 (2005).

**b. Request for Rehearing**

55. In their petition for rehearing, the MA Public Systems argue that the Commission erred in holding that protesters, rather than ISO-NE bore the burden of demonstrating that ISO-NE's proposed Schedule 2 rates were unjust, unreasonable, or unduly discriminatory. The MA Public Systems argue that the ISO's filed tariff does not set forth a formula rate requiring only annual informational filings to update the revenue requirement but files new rates under section 205 each calendar year. Because of this, MA Public Systems assert that the ISO bears the burden of justifying the rates it proposes, including the cost allocation (*i.e.*, rate design) embedded in those rates. The MA Public Systems also note that the Commission's previous acceptance of the Schedule 2 rate design is currently pending judicial review, and if those orders are vacated on appeal, the assumption underlying the burden of proof allocation in the instant proceeding will have been invalidated. The MA Public Systems further argue that ISO-NE's increases to rates applicable to non-virtual transactions, while holding the rates for virtual transactions constant, increased the discrimination between them.

56. The MA Public Systems also maintain that, regardless of the burden of proof, the Commission erred in its approval of ISO-NE's proposal. First, the MA Public Systems claim that the December 30 Order fails to consider the magnitude of the undue discrimination engendered by the proposed Schedule 2 rate design, arguing that the total collective contribution of entities who engage solely in virtual trading to ISO-NE's annual administrative costs is roughly seven ten-thousandths of the Schedule 2 revenue requirement. The MA Public Systems argue the Commission erred in accepting the Schedule 2 rates because the rates allow a favored class of market participants to pay a disproportionately low percentage of ISO-NE's annual administrative costs. Moreover, the MA Public System argue that the December 30 Order fails to articulate a principle or standard by which it will determine whether discrimination of that magnitude is due or undue. The MA Public Systems asserts that it defies both logic and experience to suggest that the market participants who submit virtual transactions could not afford to bear a greater share of ISO-NE's costs without departing the market, citing to the lack of a significant decrease in virtual trading when virtual bidders and physical bidders paid the same per transaction rate. According to the MA Public Systems, if affordability to the financial marketers is to be the test for whether massive rate discrimination is due or undue, and the Commission intends to require MA Public Systems to show that higher rates would be affordable, the Commission must at least set the issue for hearing.

57. In its answer, EPIC maintains that the MA Public Systems' claim that virtual participants are charged unduly low and discriminatory Schedule 2 rates is factually inaccurate. EPIC asserts that the \$61,746,659 figure cited by the MA Public Systems for the schedule 2 revenue requirement represents the total cost to operate, administer and build the Locational Marginal Price market and that all participants help fund this market

through the payment of administrative fees, operational charges, and other fees and charges in addition to Schedule 2 bid charges. EPIC challenges MA Public Systems' claim that the rates approved by the Commission for 2006 are expected to collect a total of \$43,738 in revenues from all market participants, or a little more than \$1,000 per capital, as wholly inaccurate, noting that EPIC alone paid over \$12,000 in 2005 and \$15,000 in 2004 and is a small virtual market participant. EPIC also challenges the MA Public Systems' claim that those engaging solely in virtual transactions are expected to produce annual revenues in 2006 of just a fraction of the predicted \$43,738 in total revenue from all market participants as inaccurate, since payments made by individual Participants are confidential.

58. EPIC also argues that the MA Public Systems' claim that other ISO-NE participants are forced to shoulder the burden of virtual participants is inaccurate. Virtual Participants such as EPIC pay a number of different ISO-NE charges, and thus it would be inaccurate to look solely at the TU charges paid to assess their total financial contribution to ISO-NE. In support, EPIC notes that in 2005 it paid over \$300,000 in ISO-NE Operating Reserve charges in addition to administrative charges and collateral requirements. EPIC also maintains that because virtual bids place no additional costs on the system, all bid charges that it pays reduce system costs that would otherwise have to be allocated to all other participants, including the MA Public Systems.

59. EPIC further argues that the schedule 2 bid charges are not unreasonable, discriminatory, or inconsistent with other RTO/ISO systems. EPIC maintains that the bid charges applied to virtual transactions in ISO-NE are consistent with or higher than the bid charges assessed by other RTOs/ISOs. EPIC maintains that the Schedule 2 bid charges must not be set at such a high level that beneficial virtual trading is discouraged or prevented, pointing out that because virtual trades are often based on small price differences between the day-ahead and real time markets, bid charges that are set too high will act to eliminate much of this very beneficial trading. EPIC concludes that the Schedule 2 charges are consistent with cost incurrence principles and are set at a level that preserves trading that is highly beneficial to the New England market.

**c. Commission Determination**

60. The Commission will deny the MA Public Systems' request for rehearing. First, the MA Public Systems are correct in noting that the Commission's prior acceptance of the schedule 2 rate design is pending review before the Court of Appeals. We recognize that "judicial review at times results in the return of benefits received under the upset administrative order."<sup>38</sup> However, the Commission may rely on contested orders even

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<sup>38</sup> *United Gas Improvement Co. v. Callery Properties, Inc.*, 382 U.S. 223, 229 (1965), *pet. for reh'g denied*, 382 U.S. 1001 (1966).

though they are pending on rehearing or appeal because the Commission's decisions are final and effective unless they have been stayed.<sup>39</sup> Accordingly, the Commission's reliance in the December 30 Order on prior schedule 2 orders is appropriate.

61. We clarify that the burden of proof of demonstrating the justness and reasonableness of the proposed costs set forth in ISO-NE's 2006 administrative cost filing was squarely on ISO-NE. As described in the December 30 Order, ISO-NE successfully supported the justness and reasonableness of the costs under the current rate design. The MA Public Systems' petition for rehearing challenges the Commission's prior acceptance of the Schedule 2 rate design, however, and for that, the burden is on the MA Public Systems.<sup>40</sup> As we held in the December 30 Order, the MA Public Systems have failed to show that the Schedule 2 rate design is not just and reasonable.

62. Further, the MA Public Systems did not raise any arguments on rehearing that the Commission has not already addressed in its December 30 Order. We understand that the charge assessed on virtual bids is significantly lower than that assessed on physical bids, and that the revenue expected to be generated from virtual bidding is expected to be only a small portion of the total Schedule 2's revenue requirement. However, virtual and real traders are not similarly situated. While the Commission has acknowledged previously

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<sup>39</sup> See section 313(c) of the FPA, 16 U.S.C. § 8251(c) (2000) ("The filing of an application for rehearing ... [or] the commencement of [review] proceedings ... shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order."); see also *Northwest Pipeline Corp.*, 88 FERC ¶ 61,298 at 61,911 (1999), *pet. for review denied sub nom., Canadian Ass'n of Petroleum Producers v. FERC*, 254 F.3d 289 (2001) (finding that "[m]erely because [an order] and related or similar cases are pending on appeal before the Court, the Commission is not required to hold other cases involving the same issues in abeyance pending the outcome of those appeals. Such a requirement would unnecessarily delay the Commission's work, to the detriment of the pipelines and their ratepayers. If the Court determines that aspects of the Commission's [contested] policy are inappropriate, cases that have followed those aspects of the policy may be addressed again where the parties have preserved their positions through requests for rehearing or through appeal.").

<sup>40</sup> See *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 186 (D.C. Cir. 1986) (citing *ANR Pipeline Co. v. FERC*, 771 F.2d 507, 514 (D.C. Cir. 1985)) (finding that "a Commission-initiated change in either [rates or method of calculation] can be accomplished only upon the agency's compliance with the strictures of section 5 [of the Natural Gas Act]. 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."); see also December 30 Order at P 41 n.19.

that due to the fixed nature of ISO-NE's costs, it has not attempted to develop Schedule 2 rates based on cost causation principles, we note that the substantially lower rate for virtual traders does not appear unreasonable considering that virtual trades impose little or no incremental costs on the system. Therefore, we affirm our determination that ISO-NE's Schedule 2 charges for virtual trades are just and reasonable.

The Commission orders:

The requests for rehearing of the issues discussed above are hereby denied.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.