

119 FERC ¶ 61,178
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

ISO New England Inc.

Docket Nos. ER07-116-000
ER07-116-001

ORDER ON PAPER HEARING AND FINDING REHEARING TO BE MOOT

(Issued May 21, 2007)

1. On December 21, 2006,¹ the Commission issued an order in this proceeding that instituted a paper hearing concerning the justness and reasonableness of ISO New England Inc.'s (ISO-NE) depreciation and amortization expenses for 2007. The Commission finds that, based on the evidence in the proceeding, that ISO-NE's depreciation and amortization expenses as set forth in its 2007 administrative cost filing are just, reasonable, and not unduly preferential or discriminatory.
2. On January 22, 2007, ISO-NE filed a request for clarification or, in the alternative, rehearing of the December 21 Order. Given our disposition of the issues in this proceeding, ISO-NE's request for clarification or, in the alternative, rehearing of the December 21 Order is dismissed as moot.

I. Background

3. On October 31, 2006 (October 31 Filing), ISO-NE filed its 2007 Core Operating Budget for the collection of its administrative costs for calendar year 2007. New England Advocates² protested ISO-NE's October 31 Filing asserting that ISO-NE had not supported its use of short average service lives and zero net salvage values in calculating

¹ *ISO New England Inc.*, 117 FERC ¶ 61,310 (2006) (December 21 Order).

² The New England Advocates consist of the Attorney General of the Commonwealth of Massachusetts; Richard Blumenthal, Attorney General for the State of Connecticut; the Connecticut Office of Consumer Counsel; the Maine Public Advocate; and the New Hampshire Office of Consumer Advocate.

depreciation of its assets. The Commission agreed, and in the December 21 Order accepted and suspended, subject to refund, proposed tariff revisions submitted by ISO-NE. The Commission ordered a paper hearing, requiring parties to “specifically address what the appropriate average service lives and net salvage values should be for the assets listed in ISO-NE’s 2007 Revenue Requirement.”³

II. Discussion

A. Procedural Matters

4. On January 22, 2007, ISO-NE filed its brief pursuant to the December 21 Order. Timely comments on the brief were filed by the New England Advocates and the New England Power Pool Participants Committee (NEPOOL). On February 20, 2007, ISO-NE filed reply comments and on March 15, 2007, the New England Advocates filed a motion for leave to answer and answer to ISO-NE’s reply comments. On March 28, 2007, ISO-NE filed an answer to the New England Advocates’ answer.

5. Rule 213(a)(2) of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to an answer unless otherwise ordered by the decisional authority. We will accept the answers filed herein because they have provided information that assisted us in our decision-making process.

B. Briefs

6. In its January 22, 2007 brief (and again in its reply comments and subsequent answer), ISO-NE states that the average service lives and salvage values it used are necessary to comply with its unique funding mechanisms, consistent with its historical experience, and repeatedly opined by its independent auditors to be appropriate. ISO-NE adds that, because the ISO does not earn any return on assets, it has no incentive to artificially inflate or deflate useful service lives or underestimate salvage values. ISO-NE contends that the Commission, therefore, should find the ISO’s average service lives and net salvage values just, reasonable, and not unduly preferential or discriminatory.

7. ISO-NE asserts that its estimates of average service lives are reasonable because they are consistent with actual practice and/or supported by appropriate analysis. ISO-NE states that it uses straight-line depreciation with no net salvage value and an average service life of three years for computer hardware and software and a 25-year composite service life for its new building and control center. ISO-NE states that it has needed to

³ December 21 Order at P 17.

replace or significantly modify the computer software and hardware it uses to operate the markets – by far the bulk of the ISO’s depreciation expense⁴ – on a roughly three year cycle.⁵ ISO-NE states that it uses a three-year service life for hardware to keep up with technological improvements, account for increases in usage, and to replace items that begin experiencing deteriorating performance due to heavy usage. Further, ISO-NE states that its future computer software needs also appear consistent with a 3-year average service life.⁶ ISO-NE adds that it uses a 25-year average service life for its building expenditures based on the opinion of independent bond counsel, as well as an analysis of the service lives of the different aspects of the building. ISO-NE explains that it bundles various types of tangible and real property building costs to arrive at the average service life of 25 years. For example, the 25-year bundled service life for its new building includes a useful life of 40 years for the steel and concrete, 25 years for the mechanical and electrical work, and 15 years for the high wear-and-tear elements, such as roofing and millwork.

8. Similarly, ISO-NE asserts that its use of zero net salvage value is just, reasonable, and not unduly preferential or discriminatory because it is supported by experience. ISO-NE states that typically it is unable to obtain salvage value for its disposed assets, particularly for customized computer software and hardware, the largest portion of its depreciation expense. The software, for example, is only useful to ISO-NE because of its customization and ISO-NE typically has to pay to have the hardware removed.

9. Finally, ISO-NE notes that its independent auditors have always opined that the average service lives and salvage values are presented fairly, in all material respects, in accordance with Generally Accepted Accounting Principles. In addition, ISO-NE states

⁴ ISO-NE states that roughly 77 percent of the total depreciation expense for 2007 involves market systems and/or enhancement projects including “Internal Development Costs.”

⁵ ISO-NE provides as examples various market-related projects (such as its Standard Market Design Project and its Ancillary Services Markets Projects) that required customized hardware and development of major customized software and had useful lives between three and four years.

⁶ ISO-NE uses as examples, its 2007 implementation of the first phase of its Forward Capacity Market capital project necessary to run the first Forward Capacity Auction in February 2008, and its 2008 implementation of the new Long Term Transmission Rights market rules, both of which will entail major software development efforts and replace portions of its existing software.

that it changed the service life for software and hardware to three years in 2002 after consultation and approval by its outside independent auditors.

10. Additionally, ISO-NE states that its unique and established funding mechanisms necessitate continuation of the current service lives and salvage values. As a non-profit regional transmission organization, ISO-NE states that it has neither equity nor return thereon from which to fund its capital expenditures. Instead, ISO-NE states that it has borrowed in the commercial market through a private placement note designed to maintain appropriate financial support for implementing its stakeholder-supported (and Commission-approved) annual capital budget for the financing of its facilities.

11. ISO-NE states that it premised this funding mechanism on the average service lives and net salvage values currently used by ISO-NE to establish annual depreciation costs recovered under the tariff. ISO-NE claims that to avoid a potential default, it would have either (i) to obtain additional loans that would increase overall costs to customers or (ii) to reduce capital spending from the levels previously forecasted by ISO-NE. ISO-NE argues that such reductions could render ISO-NE incapable of funding some capital expenditures needed to timely implement new market rules supported by stakeholders and/or required by the Commission.

12. In its reply brief and answer, the New England Advocates continue to assert that ISO-NE overstates its building and computer software depreciation accrual rates in determining its cost of service. The New England Advocates argue that ISO-NE did not provide sufficient evidence that its depreciation and amortization expenses are just, reasonable, and not unduly preferential or discriminatory. The New England Advocates concludes that the average service life for ISO-NE's new building should be set at 45 years with a positive 20 percent net salvage and the service life for software should be six years. The New England Advocates urge the Commission to order ISO-NE to: (1) change its service lives; (2) change its zero-level salvage values; and (3) make a compliance filing of separate sub-accounts for each individual investment category consistent with recommendations cited in its reply brief. In addition, the New England Advocates request that the Commission: (1) order that ISO-NE's rates are subject to refund as any other public utilities' rates; and (2) grant such further relief as the Commission deems just and proper.

13. In its comments, NEPOOL states that it supports the 2007 Operating Budget and that it should be approved. NEPOOL adds that the New England Advocates should have used the Commission-approved Participants Process to raise issues with depreciation and amortization.

C. Commission Determination on Depreciation and Salvage Issue

14. We find, based on our review of the evidence in this proceeding, that ISO-NE's depreciation and amortization expenses included in its 2007 administrative cost filing are just, reasonable, and not unduly preferential or discriminatory. ISO-NE based its estimates of a three year service life for its software and hardware on its actual experiences as well as its projections of the useful life of its current software and hardware. The New England Advocates have provided no evidence that would refute ISO-NE's estimates. Further, the Commission finds that it is reasonable to accept ISO-NE's assertion that it will not be able to obtain any positive salvage for these assets, as most of the software and hardware is customized for specific ISO-NE applications, and it is likely that ISO-NE may have to pay for its removal. Also, the Commission finds that ISO-NE's use of a 25-year bundled service life for its building based on an average of the service lives of the various components, such as steel and concrete and electrical work, is reasonable. New England Advocates, while urging a longer life, have not made a sufficient showing that ISO-NE's estimates are unreasonable. We also recognize that since ISO-NE does not earn any return on assets, it has no incentive to artificially inflate or deflate useful service lives or underestimate salvage values.

15. In summary, we find that ISO-NE has provided sufficient support of the reasonableness of the proposed depreciation and amortization expenses included in its 2007 administrative costs filing. Accordingly, we accept ISO-NE's 2007 depreciation and amortization expenses as being just, reasonable, and not unduly preferential or discriminatory.

D. ISO-NE's Request for Clarification, or in the Alternative, Rehearing

16. Finally, on January 22, 2007, ISO-NE filed a motion for clarification, or in the alternative, rehearing of the refund requirement in the December 21 Order.⁷ ISO-NE England states that the Commission does not explain the manner in which the ISO-NE's billing would be changed to implement refunds. ISO-NE states that if the Commission issues an order following the paper hearing that requires different depreciation and salvage value assumptions from those ISO-NE proposed, ISO-NE can lower the corresponding elements of its operating budget prospectively for the remainder of calendar year 2007 and lower its 2007 administrative cost rates prospectively to reflect those reduced costs. ISO-NE is concerned, however, if the Commission intended that its refund obligation were to be retroactive to the effective date of its 2007 rates.

⁷ December 21 Order at note 19.

17. Given that the Commission is accepting ISO-NE's proposed depreciation and amortization expenses and not requiring refunds, the Commission finds ISO-NE's request for clarification or rehearing to be moot.

The Commission orders:

(A) ISO-NE's depreciation and amortization expenses as set forth in its 2007 administrative cost filing are just, reasonable, and not unduly preferential or discriminatory and are accepted, as discussed in the body of this order.

(B) ISO-NE's refund obligation is terminated, and its proposed 2007 administrative cost rates are accepted, without condition, effective January 1, 2007.

(C) ISO-NE's request for clarification or, in the alternative, rehearing of the December 21 Order is dismissed as moot, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.