

127 FERC ¶ 61,254
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

ISO New England Inc.

Docket No. ER09-197-001

ORDER DENYING REHEARING

(Issued June 18, 2009)

1. Richard Blumenthal, Attorney General for the State of Connecticut (Connecticut AG) and the Connecticut Office of Consumer Counsel (Connecticut OCC) (together, the Joint Advocates) request that the Commission grant rehearing of its order¹ accepting ISO New England Inc.'s (ISO-NE) October 31, 2008 Filing of Revised Tariff Sheets for Recovery of 2009 Administrative Costs (October 31 Filing). The Joint Advocates seek rehearing of findings in the December 31 Order regarding ISO-NE's requested executive compensation and salary structure, employee staffing levels, depreciation rates and schedules, and external affairs activities and ask the Commission to hold a full evidentiary hearing in this proceeding to determine whether the proposed budget would result in unjust and unreasonable rates. For the reasons discussed below, we will deny rehearing.

I. Background

2. In its October 31 Filing, ISO-NE proposed changes to section IV.A of its Transmission, Markets and Services Tariff (Tariff) to collect its administrative costs for the calendar year 2009 (2009 Revenue Requirement). ISO-NE stated that its 2009 Revenue Requirement is \$123.4 million. The proposed 2009 Revenue Requirement was

¹ *ISO New England Inc.*, 125 FERC ¶ 61,392 (2008) (December 31 Order)

composed of several elements: the 2009 “Core Operating Budget” (\$99.5 million);² “Debt Service” (\$28.8 million);³ and “True-Up Amounts” for 2007 and 2008 (reductions of \$1.7 million and \$3.3 million, respectively).

3. In the October 31 Filing, ISO-NE asserted that it had endeavored to keep its 2009 Core Operating Budget for continuing services flat, with any increase tied to specific new initiatives.⁴ According to ISO-NE, it had been able to absorb most of the labor costs associated with additional projects and responsibilities by realizing efficiencies in its organization. ISO-NE proposed increasing its Core Operating Budget by approximately \$8.5 million to fund new initiatives, e.g., a Compliance Management Program, Transmission Planning/Economic Studies, and Demand Resource Integration. ISO-NE explained that the Forward Capacity Market activities were continuing to represent a large portion of the Core Operating Budget, specifically \$4.8 million in such related costs.

4. ISO-NE also stated that it had allocated \$4 million for increased benefit plan costs and a 3.5 percent increase in salaries for merit and a 1 percent increase for promotions to reflect the increasingly competitive labor market for services crucial to its operations.⁵ ISO-NE explained that it had reviewed survey data from several national compensation consultants on expected merit and promotional pool increases, as well as expected salary range adjustments for the coming year. ISO-NE then used the information to establish its salary merit and promotional pools and ranges for the coming fiscal year.

5. Regarding executive salaries and board compensation, ISO-NE explained that it had to comply with Internal Revenue Service (IRS) standards governing the reasonableness of compensation for executives and directors of 501(c)(3) corporations, to

² ISO-NE noted that the 2009 Core Operating Budget reflects a 9.4 percent increase from 2008, necessitated primarily by the implementation of several new projects and planning processes.

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

⁴ October 31 Filing at 2.

⁵ *Id.* at 12.

include base salary and all bonuses.⁶ To ensure compliance, ISO-NE stated that it had engaged a nationally recognized, independent consulting firm, Mercer Consulting, to evaluate the compensation offered by similarly situated entities. ISO-NE and its consultant had determined that ISO-NE's executive and Board compensation were within a reasonable range of competitive practice for functionally comparable positions among similarly-situated entities.

6. ISO-NE stated the Commission recently had the opportunity to closely examine, through an extensive paper hearing, ISO-NE's external affairs activities and expenditures.⁷ According to ISO-NE, its external affairs expenditures represent its efforts to monitor relevant legislation, provide outreach and education to state and federal legislators and regulators, respond to media inquiries, and educate consumers on energy efficiency.⁸ ISO-NE cited the Commission's findings that "because ISO-NE has shown that its informational activities were directly related to existing or proposed core operations and undertaken to benefit its ratepayers, it may recover the costs associated with those activities."⁹ In the October 31 Filing, ISO-NE also asserted that its external affairs expenditures in 2009 will be just and reasonable and properly recoverable from customers, but to the extent that they constitute "lobbying" as defined by the Internal Revenue Code, they will also be well within the permitted thresholds for those types of expenses.¹⁰

7. In the October 31 Filing, ISO-NE explained that its Debt Service includes the following components: (i) recovery of depreciation; (ii) amortization of regulatory assets and interest expense necessary to repay principal and interest on Commission-approved capital borrowings; and (iii) working capital borrowings. ISO-NE also detailed that for 2009, depreciation and amortization constitute \$25.8 million, while interest expense constitutes \$3 million, for a total Debt Service amount of \$28.8 million, which is a \$3.4

⁶ *Id.* at 13.

⁷ *ISO New England Inc.*, 117 FERC ¶ 61,070 (2006) (External Affairs Order), *order on reh'g and clarification*, 118 FERC ¶ 61,105, *order rejecting reh'g*, 120 FERC ¶ 61,122 (2007), *aff'd Braintree Elec. Light Dept. v. FERC*, 550 F.3d 6 (D.C. Cir. 2008).

⁸ October 31 Filing at 13.

⁹ External Affairs Order, 117 FERC ¶ 61,070 at P 42.

¹⁰ October 31 Filing at 13-14.

million decrease from 2008.¹¹ ISO-NE stated that it used a straight-line depreciation methodology based on no net salvage value and certain average service lives. In support of its filing, ISO-NE noted that its 2009 Operating Expense Budget was unanimously approved (with abstentions) by the New England Power Pool (NEPOOL) Participants Committee, its primary stakeholder body, and was approved by ISO-NE's Board of Directors.

8. The Joint Advocates protested the October 31 Filing, asking the Commission to reject ISO-NE's proposed budget on the basis that it failed to provide any supporting evidence for its proposed costs. Therefore, the Joint Advocates urged the Commission to set the matter for a hearing and to investigate the costs associated with ISO-NE's executive compensation and salary structure, employee staffing and compensation levels, depreciation and amortization schedules, and external affairs activities. In an answer, ISO-NE to the Joint Advocates' protest, ISO-NE provided additional information to justify its proposed budget, including Mercer Consulting's report on the executive compensation package and testimony regarding employee staffing levels, depreciation rates and schedules, salary and benefits, and external affairs activities.

9. In the December 31 Order, we accepted ISO-NE's proposed tariff revisions. Because we found that ISO-NE adequately supported its executive compensation package, we did not set this matter for hearing. We noted that to ensure compliance with IRS standards governing the reasonableness of total compensation for executives,¹² ISO-NE had engaged Mercer Consulting, a nationally recognized independent consulting firm, to conduct an annual independent evaluation of the reasonableness of the proposed executive compensation. Mercer Consulting examined compensation offered by similarly situated entities, including other independent system operators and RTOs and incorporated a broader comparison across all industries for positions not unique to utilities. Mercer Consulting concluded that ISO-NE's executive compensation is within a reasonable range of competitive practices for functionally comparable positions among similarly-situated entities. Using this information, ISO-NE's independent Board of Directors approved the executive compensation package. And although ISO-NE did not include the information as part of its original filing, it did provide details on the executive base pay and bonuses in its Answer. On the basis of this information, we concluded that

¹¹ *Id.* at 14-15.

¹² Under the IRS standards, executive compensation must fall within a range of competitive practices for similarly situated organizations for functionally comparative positions.

ISO-NE justified its proposed executive compensation package and found ISO-NE's proposed executive compensation package to be just and reasonable.

10. We also found that ISO-NE had adequately supported its employee salary and benefit package and, therefore, did not set this matter for hearing. ISO-NE reviewed survey data from five national compensation consultants on expected merit and promotional pool increases, as well as expected salary range adjustments for the coming year in order to calculate its proposed salary and benefit expenses. Moreover, ISO-NE management recommended the lowest possible increases and its Compensation and Human Resources Committee chose the low end of each range of the survey data in light of the economic conditions and management's recommendation. Based on this evidence, we found ISO-NE's proposed salary and benefits package to be just and reasonable.

11. With respect to its proposed staffing level increases, ISO-NE explained in its Answer that the proposed staffing increases are directly attributable to new initiatives included in the 2009 budget. ISO-NE explained the extensive steps taken to make headcount requests and to review and revise those requests before being shared with stakeholders and the Board of Directors. Therefore, we found that ISO-NE has sufficiently justified its proposed staff increase and did not set the matter for hearing.

12. We also found that ISO-NE's depreciation and amortization expenses included in its October 31 Filing are just and reasonable. In the October 31 Filing, ISO-NE used the same depreciation and amortization expenses previously reviewed by the Commission in a paper hearing and found to be just, reasonable, and not unduly preferential or discriminatory.¹³ Since the Joint Advocates offered the same argument that we previously rejected,¹⁴ we accepted ISO-NE's proposed depreciation and amortization expenses and rejected the Joint Advocates' request for a full depreciation study and hearing.

13. Finally, we found ISO-NE's external affairs expenditures are directly related to ISO-NE's core responsibilities and benefit its ratepayers, thus making them recoverable as discussed in the External Affairs Order. We found that ISO-NE demonstrated that the external affairs expenditures represent its efforts to monitor relevant legislation, provide outreach and education to state and federal legislators and regulators, respond to media inquiries, and educate consumers on energy efficiency. We noted that the monthly reports that ISO-NE must post regarding potentially non-recoverable communications

¹³ See *ISO New England Inc.*, 117 FERC ¶ 61,310, at P 17 (2006).

¹⁴ *ISO New England Inc.*, 119 FERC ¶61,178, at P 14-15 (2007).

expenditures will allow interested parties to pursue further information or action regarding these expenditures, should they deem it necessary.¹⁵

II. Joint Advocates' Submission and Position

14. On rehearing, the Joint Advocates submit that the Commission erred in the December 31 Order by arbitrarily, capriciously, and without substantial evidence concluding, first, that the executive compensation package and salary levels proposed by ISO-NE were just and reasonable and, second, that the staffing and compensation levels, depreciation and amortization schedules, and the funding for external affairs activities proposed by ISO-NE were just and reasonable.

15. The Joint Advocates argue that ISO-NE provided insufficient evidence that its executive compensation proposal is just and reasonable. They maintain that in its October 31 Filing, ISO-NE sought Commission approval for its executive compensation packages, including base pay as well as bonuses, but without any disclosure whatsoever of precisely what it proposes to pay its executives, whether base pay or in bonuses. Instead, the Joint Advocates argue that ISO-NE merely stated that “the ISO has engaged a nationally recognized, independent consulting firm, which evaluates the compensation offered by similarly situated entities. . . . The resulting opinion is that ISO’s executive and Board compensation is within a reasonable range of competitive practice for functionally comparable positions among similarly-situated entities.”¹⁶ The Joint Advocates recognize that in its December 8 Answer to the Joint Advocates’ Protest, ISO-NE provided the Commission with a report by Mercer Consulting which concludes the proposed executive compensation is reasonable.¹⁷

16. The Joint Advocates urge the Commission to reconsider this issue and to set this matter for an evidentiary hearing. They claim the Commission’s failure to provide any hearing or opportunity to contest ISO-NE’s executive compensation threatens to undermine the public confidence in the fairness of the proceedings. They argue that by not setting the executive compensation package for hearing, the Commission is allowing only minimal procedural protections, while recognizing the importance of transparency with respect to executive compensation and bonuses. In support of this statement, Joint

¹⁵ December 31 Order, 125 FERC ¶ 61,392 at 39 n.43.

¹⁶ October 31 Filing, Exhibit 3, Ludlow Testimony at 17.

¹⁷ ISO-NE Answer, Exhibit 8.

Advocates point to a footnote in the December 31 Order, where the Commission stated that “ISO-NE also disclosed such information in the NEPOOL Budget and Finance Subcommittee. That disclosure is important, but it is not a substitute for ISO-NE filing such information with the Commission.”¹⁸

17. Moreover, the Joint Advocates reiterate that the Commission should not accept on face value, and without any hearing, ISO-NE’s paid consultant’s testimony that the executive compensation proposals are reasonable. The Joint Advocates suggest that Mercer Consulting only supported the executive compensation package in order to be hired the following year.¹⁹ The Joint Advocates believe they should be entitled to a hearing process in order to challenge both the methodology and conclusions in Mercer Consulting’s report. For example, the Joint Advocates oppose the Mercer report’s examination of ISO-NE’s executive compensation levels within a framework of “competitive practices.”²⁰ The Joint Advocates claim that ISO-NE’s use of a range of companies including those with much higher revenues than its own in the proxy comparison group distorts Mercer Consulting’s results. The Joint Advocates claim that, as a relatively small “non-profit” public utility with demonstrably fewer risks, ISO-NE should not be compared to larger, more heavily capitalized, more risky, for-profit business interests.

18. Also, the Joint Advocates argue that, since Mercer Consulting’s report was provided to ISO-NE in March of 2008, it is no longer relevant due to the severe economic recession into which New England and the United States in general are entering. They claim that, as a direct result of this crisis, there has been a dramatic shift in the public perception of what constitutes an “appropriate” level of executive salary and bonus compensation. The Joint Advocates state that what many experts believed in March 2008 constituted appropriate executive salary and bonus compensation would be outdated and irrelevant today. Thus, the Commission should provide the Joint Advocates with the opportunity to challenge both Mercer Consulting’s methodology as well as their conclusions’ relevance to today’s market conditions.

¹⁸ December 31 Order, 125 FERC ¶ 61,392 at n.37.

¹⁹ Joint Advocates Rehearing Request at 5. “Obviously, if ISO-NE’s consultant [Mercer Consulting] never had to face any challenge to their conclusions or methodology, the consultant’s only incentive would be to approve of every executive compensation proposal, no matter how lavish or inappropriate. Otherwise, the consultant would be assured that it would not be hired again next year.”

²⁰ ISO-NE Answer, Exhibit 8 at 4.

19. Next, the Joint Advocates argue that the Commission should rehear its determinations that ISO-NE's total staffing and compensation to its employees, its depreciation and amortization schedules, and external affairs costs are just and reasonable. The Joint Advocates complain that in its December 31 Order, the Commission rejected each and every one of their requests for an evidentiary hearing concerning ISO-NE's employee staffing and compensation levels, proposed depreciation schedules, and external affairs budget. The Joint Advocates also allege that the Commission provided very little analysis to support its determinations, often simply accepting ISO-NE's proposal without comment. Therefore, the Joint Advocates urge the Commission to reconsider its December 31 Order to allow for a full hearing on each of these budget items.

III. Discussion

20. We reaffirm our finding in the December 31 Order that ISO-NE has adequately supported its executive compensation package, and thus we will not set this matter for hearing.²¹ While we agree with the Joint Advocates that transparency is important, we noted in the December 31 Order, as we do now, that the ISO-NE provided the information in its Answer necessary to allow the Commission to determine its proposed compensation package was just and reasonable.²²

21. Having been given the necessary information, we reaffirm our finding that we are satisfied with ISO-NE's reliance on Mercer Consulting and the consultants' report. Mercer Consulting is a nationally recognized independent consulting firm that conducted the annual independent evaluation of the reasonableness of the proposed executive compensation based on similarly situated entities such as other regional transmission organizations and independent system operators, as well as a broader comparison across all industries for positions not unique to utilities. The resulting opinion of the consulting firm is that ISO-NE's executive compensation is within a reasonable range of competitive practices for functionally comparable positions among similarly-situated entities. Using this information, as well as the recommendations of ISO-NE's Compensation and Human Resources Committee, ISO-NE's independent Board of Directors approved the executive compensation package, and we have not been persuaded that it is not just and reasonable.

²¹ December 31 Order, 125 FERC ¶ 61,392 at P 33.

²² *Id.* P 35.

22. We also find that Joint Advocates have not supported their claim that Mercer Consulting gave a biased report to ensure being re-hired. Mercer Consulting's motivations are no different from any other independent paid consultant's, including any that the Joint Advocates themselves would hire. Finally, regarding the current economic situation and its applicability, ISO-NE considered economic conditions when it chose the low end of each range of the survey data.²³ Furthermore, when the ISO-NE files seeking approval for executive compensation again, it may use any new benchmarks that have arisen due to the economic situation at that time. For now, ISO-NE's compensation package is based on the facts as they existed when it proposed its budget and submitted it for stakeholder approval.

23. Regarding whether ISO-NE's total staffing and compensation to its employees, its depreciation and amortization schedules and external affairs costs are just and reasonable, we deny the Joint Advocates request for a hearing on these issues. The Commission is not required to hold trial-type evidentiary proceedings where there are no disputed material issues of fact.²⁴ The proponent of a trial-type hearing also must make a proffer of evidence as to those disputed facts that it alleges requires a hearing.²⁵ Joint Advocates submitted their arguments in detail in their protest to the October 31 Filing and we determined in the December 31 Order that we had a sufficient record before us to make our decision in the December 31 Order, and nothing raised on rehearing persuades us that an evidentiary hearing is now needed.

²³ *Id.* P 23, 36.

²⁴ *Union Pacific Fuels, Inc. v. FERC*, 129 F.3d 157, 164 (D.C. Cir. 1997).

²⁵ *Cerro Wire & Cable Co. v. FERC*, 677 F.2d 124, 129 (D.C. Cir. 1982); *Woolen Mill Ass'n v. FERC*, 917 F.2d 589, 592 (D.C. Cir. 1990).

The Commission orders:

The Joint Advocates' request for rehearing is hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.