



Memorandum

To: ISO Board of Governors

From: Ryan Seghesio, Vice President, Chief Financial Officer & Treasurer

Date: December 5, 2018

Re: **Decision on fiscal year 2019 budget**

This memorandum requires Board action.

This memorandum summarizes the final 2019 budget proposal that the Board is requested to approve and which will become effective January 1, 2019. A high-level review of the key budget sections follows in the discussion and analysis section; however, a more detailed description and review of the budget can be found in the 2019 Budget and Grid Management Charge Rates book, included as *Attachment A*.

The proposed revenue requirement of \$193.5 million remains within the tight range that the ISO has maintained over the past thirteen budget cycles and beneath the FERC-approved cap of \$202 million. The ISO continues to absorb upward cost pressures in operations and maintenance (O&M) expenses by continuing to achieve efficiencies in non-labor costs and increasing other revenues such as with the Reliability Coordinator Funding Requirement set to kick off in 2019. The result is a \$3.7 million decrease in the revenue requirement compared to 2018.

Management recommends the following motion:

Moved, that the ISO Board of Governors approves the 2019 revenue requirement, capital/project budget, and resulting rates as set forth in Attachment A to the memorandum dated December 5, 2019.

DISCUSSION AND ANALYSIS

The annual revenue requirement is an integral component of the ISO's planning process and reflects the priorities and commitments made in the ISO's strategic vision.

The 2019 revenue requirement, at \$193.5 million, is approximately \$8.5 million less than the FERC-approved \$202 million cap. This amount is \$3.7 million (or 2%) lower in comparison to the 2018 revenue requirement and represents an average annual growth rate of less than 1% since 2007. The ISO projects that the 2019 transmission volume will decrease to 239.7 terawatt-hours (TWh), which results in a bundled cost per

megawatt-hour (MWh) of \$0.807, or a decrease of \$0.010 per MWh from 2018. The bundled costs per megawatt-hour (MWh) is derived by dividing the revenue requirement by the forecasted transmission volume. The 2019 projected volumes at 239.7 TWh, are less than 1% less than the 2018 budgeted volumes based on the three-year average of actual measured demand volumes as well as the year-to-date 2018 volumes.

The revenue requirement has five components:

- Operating and maintenance (O&M) budget
- debt service;
- cash funded capital;
- other costs and revenues; and
- operating cost reserve adjustment from prior year.

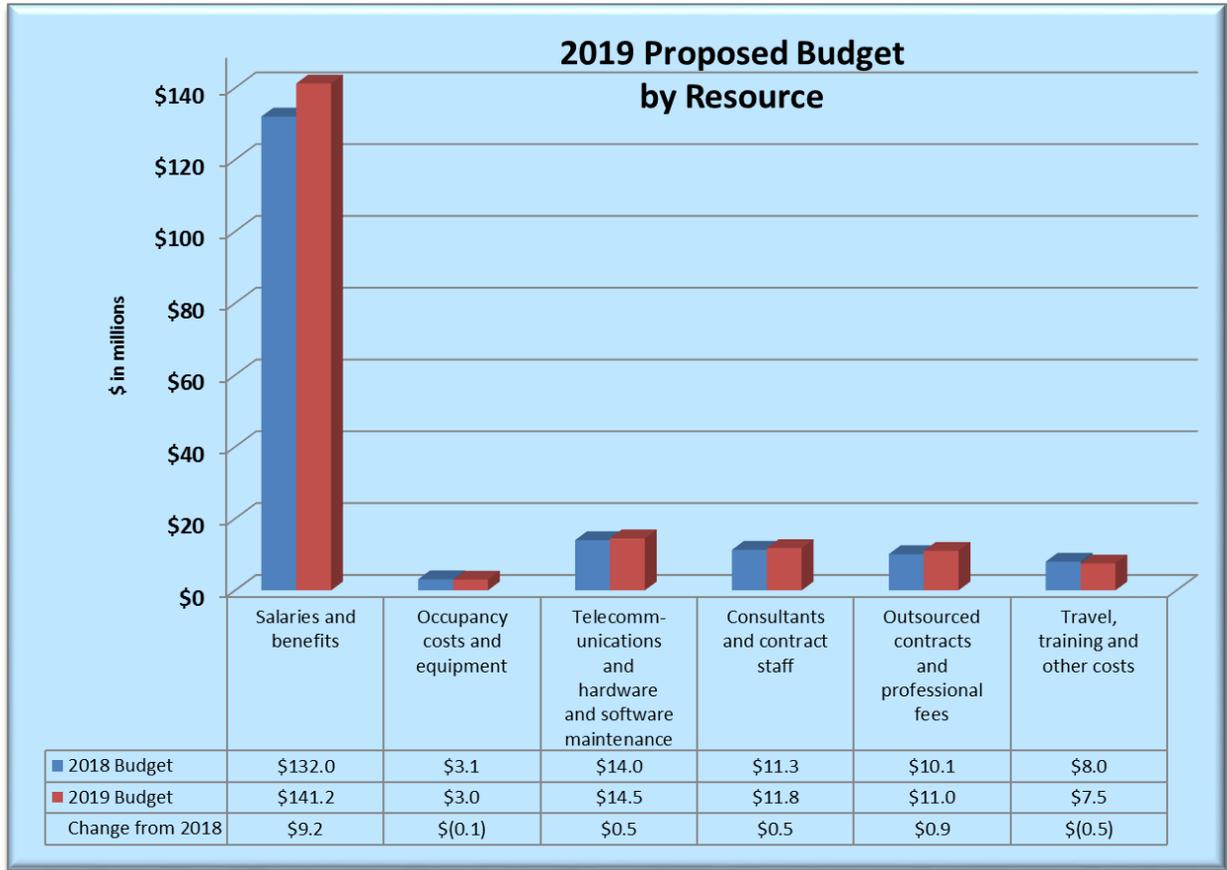
A summary of the 2019 revenue requirement compared to 2018 is as follows.

Revenue Requirement Components (\$ in millions)	2019 Budget	2018 Budget	Change \$
Operations & Maintenance Budget	\$189.0	\$178.5	\$10.5
Debt Service (including 25% reserve)	16.9	16.9	0.0
Cash Funded Capital	25.0	22.0	3.0
Other Costs and Revenues	(23.9)	(16.7)	(7.2)
Operating Costs Reserve Adjustment	(13.5)	(3.5)	(10.0)
Total Revenue Requirement	\$193.5	\$197.2	(\$3.7)
Transmission Volume Estimate in TWh	239.7	241.3	(1.6)
Pro-forma bundled cost per MWh	\$0.807	\$0.817	(\$0.010)

Operating and Maintenance Budget

The O&M budget is the largest component of the revenue requirement; it accounts for the majority of the total revenue requirement. The 2019 proposed O&M budget is \$189 million, representing a \$10.5 million, or 6%, increase over 2018. The 2019 Budget and Grid Management Charge Rates book, included as *Attachment A*, presents the O&M budget in three different perspectives: delivery of services (objectives and processes), utilization of resources, and divisional costs.

A summary of the 2019 O&M budget by resource compared to 2018 is as follows.



- Salaries and benefits grew due to 28 additional headcount (primarily in support of the new Reliability Coordinator services), merit increases, as well as additional benefit burden costs.
- Occupancy costs decreased due to efficiency made in managing facilities costs
- Telecommunications and hardware and software maintenance costs increased due to demand for additional telecommunications, hardware and software needs
- Consultants and contract staff expense increased primarily due to need for additional outsourced studies
- Travel expense decreased primarily due to decreased need for travel

Debt Service

The debt service component of the 2019 revenue requirement will be \$16.9 million, the same as in 2018. Debt service includes the amounts due, plus the required 25 percent reserve. The outstanding bond principal going into 2019 is \$173.5 million.

A summary of debt service is as follows.

Debt Service (\$ in millions)	2019 Budget	2018 Budget	Change
Principal payments	\$5.0	\$4.8	\$ 0.2
Interest payments	8.5	8.7	(0.2)
Subtotal	13.5	13.5	-
25 % Debt Service Reserve	3.4	3.4	-
Total	\$16.9	\$16.9	\$ -

Capital and Project Budget and Cash Funded Capital

The proposed revenue requirement will allow for the collection of \$25 million for cash funded capital. Excess amounts collected will be used to fund future projects.

The 2019 capital/project budget is requested to be set at \$22 million. The current list of proposed projects that would consume the \$22 million budget is contained in *Attachment A*. These projects, and other proposed projects, will continue to be prioritized in 2019 under the ISO's capital/project approval process.

Other Costs and Revenues

Other revenue increased by \$7.2 million to \$23.9 million primarily driven by the addition of the Reliability Coordinator Funding Requirement and planned addition of Balancing Authority of Northern California/Sacramento Municipal Utility District into the energy imbalance market in April 2019 as well as higher anticipated forecasting revenue and interest earnings. These revenue items help bring the revenue requirement below the \$202 million cap.

A summary of other costs and revenues is as follows.

Other Costs and Revenue (\$ in millions)	2019 Budget	2018 Budget	Change
Energy Imbalance Market Administrative Charges	\$8.6	\$7.4	\$1.2
Reliability Coordinator Funding Requirement	4.3	-	4.3
Intermittent Resource (wind and solar) Forecasting Fees	3.8	3.2	0.6
Interest Earnings	3.3	2.5	0.8
California-Oregon Intertie Path Operator Fees	2.0	2.0	-
Generation Interconnection Project Fees	1.5	1.2	0.3
Scheduling Coordinator Application and Other Fees	0.4	0.4	-
Total	\$23.9	\$16.7	\$7.2

Operating Cost Reserve Adjustment

The operating cost reserve adjustment is primarily the cumulative result of the actual results versus the budgeted revenue requirement and the 25% debt service reserve collection from the prior year. For 2019, the ISO forecasts a credit from the operating reserve account of \$13.5 million based on the trued-up activity from 2017.

As with other revenue, this credit adjustment helps bring the revenue requirement below the \$202 million cap.

A summary of the operating reserve adjustment is as follows.

Operating Cost Reserve Adjustment (\$ in millions)	2019 Budget	2018 Budget	Change
Increase/(decrease) in 15% reserve for O&M budget	\$(1.6)	\$(0.7)	\$(0.9)
25% debt service collection from prior year	3.4	3.4	-
True-up of actual to forecast revenues and other expenses	11.7	0.8	10.9
Total	\$13.5	\$3.5	\$10.0

Grid Management Charge Rates, Fees, and Charges

A comparison of the proposed 2019 rates and 2018 rates is as follows (\$ per unit).

Comparison of Charges, Fees, and Rates	2019 Amount Per Unit	2018 Amount Per Unit	Change \$
Grid Management Charges			
Market Service Charge	\$0.1065	\$0.1100	(\$0.0035)
Systems Operations Charge	\$0.2797	\$0.2964	(\$0.0167)
CRR Services Charge	\$0.0050	\$0.0038	\$0.0012
Supplemental Services Rates			
EIM Market Service	\$0.0841	\$0.0869	(\$0.0028)
EIM System Operations	\$0.1091	\$0.1156	(\$0.0065)
RC Service Rate	TBD	N/A	N/A

The 2019 RC Service Rates will be released in the first quarter of 2019, which will allow the ISO time to determine its Reliability Coordinator footprint going into its initial service year.

The EIM Administrative Charges are derived from the GMC rates. As established in the latest cost of service study, EIM entities pay 79% of the Market Services rate and 39% of the System Operations rate.

All miscellaneous fixed fees remain the same.

Budget Process

The ISO has provided several opportunities for public review and comment on the draft budget. This public input process commenced with a July budget kickoff meeting with stakeholders and followed with a stakeholder call held in November. The ISO posted materials from the meetings as well as stakeholder comments and ISO responses on its website. The stakeholder comments consisted of clarifying questions regarding items such as planned 2019 projects, CRR volume projections and CRR rate, along with general O&M questions; the consensus was the stakeholders were supportive of the revenue requirement. With Board approval, the ISO will post the proposed GMC rates on its website to be effective on January 1, 2019.

It should be noted that post-decision minor adjustments are sometimes required to line items within the O&M budget due to final year-end headcount and cost center reorganizations. These year-end adjustments will not affect the final total approved budget.

Conclusion

The proposed budget will provide sufficient funding to enable the ISO to deliver on the commitments it made to achieve its vision while still maintaining the costs to customers. Therefore, Management recommends that the Board approve the budget attached to this memorandum.