



Memorandum

To: ISO Board of Governors

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

Date: December 7, 2022

Re: **Decision on 2023 budget**

This memorandum requires ISO Board of Governors action.

This memorandum summarizes the final 2023 GMC revenue requirement proposal that the Board is requested to approve and which will become effective January 1, 2023. 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 2023 Budget and Grid Management Charge Rates book, included as *Attachment A*.

At \$199.7 million, the proposed 2023 GMC revenue requirement is \$17.1 million higher than the 2022 GMC revenue requirement. The primary driver is the increase in the operations and maintenance (O&M) budget component of the revenue requirement. The 2023 O&M budget is 13% higher than 2022 primarily due to higher labor costs driven by inflationary pressures and funding for 52 new positions intended to address strain points within the organization. The ISO will offset some of the operating cost increase through continued growth in the other revenue categories, a smaller collection of capital, and a sizeable return of funds through the operating reserve credit.

Management recommends the following motion:

Moved, that the ISO Board of Governors approves the 2023 GMC revenue requirement, capital/project budget, and resulting rates as set forth in Attachment A to the memorandum dated December 7, 2022.

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 2023 GMC revenue requirement, at \$199.7 million, is approximately \$2.3 million less than the FERC-approved \$202 million cap. The 2023 GMC revenue requirement is \$17.1 million higher in comparison to the 2022 GMC revenue requirement. The draft final (current) version of GMC revenue requirement is \$0.1 million higher than the draft version

released in October 2022. The change in the revenue requirement is due to an increase in the O&M budget and a slight reduction in the operating cost reserve credit. These increases were offset by a reduction in the cash funded capital collection and an increase in other revenue. The additional O&M budget is driven by two additional positions, additional consultant needs, and additional maintenance support. The decrease in the operating cost reserve credit is due to the change in the O&M budget reserve. The cash funded capital request was reduced by \$1 million to help offset the increase in the O&M budget. The other revenue increase is driven by higher projected Hosted Advanced Network Applications (HANA) administrative and setup fees.

The ISO projects that the 2023 transmission volume will increase to 234.2 terawatt-hours (TWh), which results in a pro-forma bundled cost per megawatt-hour (MWh) of \$0.8527, or an increase of \$0.0707 per MWh from 2022.

The 2023 GMC revenue requirement was developed using the most recent cost of service study results. The ISO completed its scheduled triennial cost of service study in 2020, in accordance with its tariff. The study used activity based costing to analyze cost and time data from 2019 to determine how much time and effort staff uses to support varying cost categories and supplemental services. The updated cost percentage allocations and fees, as a result of the cost of service study, were used to develop the 2021 through 2023 GMC revenue requirement and resulting charges. The updated cost category allocation percentages are used to allocate the revenue requirement to the market services, system operations, and congestion revenue rights (CRR) services. The study results were also used to update the Western Energy Imbalance Market (WEIM) cost category percentages and the recently developed reliability coordinator (RC) funding percentage. In addition, as part of the cost of service study, the ISO analyzed its cost to support supplemental services.

The GMC revenue requirement has five components:

- operations and maintenance budget
- debt service
- cash funded capital
- other costs and revenues; and
- operating cost reserve adjustment

A summary of the 2023 GMC revenue requirement compared to 2022 is as follows.

GMC Revenue Requirement (\$ in millions)	2023 Budget FINAL	Change in Versions	2023 Budget DRAFT	2022 Budget	Change \$	Change %
Operations & Maintenance Budget	\$238.4	\$1.1	\$237.3	\$210.7	\$27.7	13%
Debt Service (including 25% reserve)	14.7	-	14.7	14.7	0.0	0%
Cash Funded Capital	21.0	(1.0)	22.0	30.0	(9.0)	-30%
Other Costs and Revenues	(57.6)	(0.1)	(57.5)	(53.7)	(3.9)	7%
Operating Cost Reserve Adjustment	(16.8)	0.1	(16.9)	(19.1)	2.3	-12%
Total GMC Revenue Requirement	\$199.7	\$0.1	\$199.6	\$182.6	\$17.1	9%
Transmission Volume Estimate in TWh	234.2	0.0	234.2	233.5	0.7	0%
Pro-forma bundled cost per MWh	\$0.8527	\$0.0004	\$0.8523	\$0.7820	\$0.0707	9%

Operations 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 2023 proposed O&M budget is \$238.4 million, representing a \$27.7 million increase over 2022. The 2023 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 functional costs.

A summary of the 2023 O&M budget by resource compared to 2022 is as follows:

- The salaries and benefits category will increase primarily due to 52 additional positions, merit increases and other compensation increases; these increases are slightly offset by a reduced benefit burden rate and a vacancy discount rate.
- The occupancy costs and equipment category will remain flat.
- The telecommunications and hardware and software maintenance category will increase primarily due to a new backup network service for the reliability coordinator services, enhanced firewall, network equipment, and additional licensing needs driven by growing staff.
- The consultants and contract staff category will increase due to need for additional consulting needs to support resource adequacy studies, process assessments, training, day-ahead-market studies, technology and operations applications maintenance, and the need for subject matter experts in various fields such as renewable integration.

- The outsourced contracts and professional fees category will increase due to additional outsourced tools and migration of licenses to subscription based support. This increase was slightly offset by a reduction in audit services budget.
- The travel, training and other costs category will increase primarily due to anticipated travel needs and insurance premium increases.

Debt Service

The debt service component of the 2023 GMC revenue requirement will remain \$14.7 million. Debt service includes the principal and interest amounts due on the Series 2021 bonds, plus the required 25 percent reserve. The outstanding bond principal going into 2023 is \$165.4 million (assuming the GMC revenue requirement cycle).

The Series 2021 bonds were issued in January 2021 to refinance the 2013 bonds. The refinancing of the 2013 bonds will save the ISO approximately \$30 million in principal and interest over the life of the bonds. The 2013 bonds were issued to finance the ISO’s headquarters facility in Folsom, California and to fund other capital expenditures. Below is the future amortization schedule for the 2021 bonds. Note: The bonds are callable on February 1, 2031.

A summary of debt service is as follows:

Debt Service (\$ in millions)	2023 Budget	2022 Budget	Change
Principal payments	\$8.7	\$8.7	\$0.0
Interest payments	3.0	3.0	0.0
Subtotal	11.7	11.7	0.0
25% debt service reserve	3.0	3.0	0.0
Total Debt Service	\$14.7	\$14.7	\$0.0

Capital and Project Budget / Cash Funded Capital

The 2023 cash-funded capital component of the GMC revenue requirement is \$21 million and the capital / project budget is \$25 million to fund projects. The ISO will leverage its capital reserve to fund the \$4 million delta between the cash-funded capital request and the capital / project budget request. The ISO has slowly built its capital reserve fund since 2010 as a means to help stabilize the GMC revenue requirement by contributing unencumbered cash-funded capital dollars to it.

The current list of proposed projects that would consume the \$25 million budget is contained in *Attachment A*. These projects, and other proposed projects, will continue to be prioritized in 2023 under the ISO’s capital/project approval process.

Other Costs and Revenues

Other costs and revenue will increase by \$3.9 million to \$57.6 million, primarily due to additional revenues from the Reliability Coordinator (RC) funding requirement and additional entities joining WEIM in 2023. This component, representing net revenues received outside of the GMC, lowers the overall GMC revenue requirement. By diversifying its revenue streams, the ISO is able to maintain disciplined growth in its revenue requirement (and ultimately favorable rates) while still developing well-rounded O&M and capital budgets that serves its needs.

A summary of other costs and revenues is as follows.

Other Costs and Revenue (\$ in millions)	2023 Budget	2022 Budget	Change
Reliability Coordinator Funding Requirement	\$19.7	\$18.0	\$1.7
Western Energy Imbalance Market Administrative Charges	15.3	14.1	1.2
Nodal Pricing Model Fee	8.4	8.4	-
Intermittent Resource (wind and solar) Forecasting Fees	5.5	5.0	0.5
Interest Earnings	4.0	3.8	0.2
Generation Interconnection Project Fees	2.0	2.0	-
HANA Administrative and Setup Fees	1.1	0.9	0.2
Scheduling Coordinator Application and Other Fees	0.9	0.8	0.1
California-Oregon Intertie Path Operator Fees	0.7	0.7	-
Total Other Costs and Revenue	\$57.6	\$53.7	\$3.9

The RC funding requirement, calculated at \$19.7 million, represents the amount of revenue the ISO requires to offset the costs it will incur to provide RC services. The RC funding requirement is calculated as a percentage, known as the RC funding percentage, of the revenue requirement. The increase in the funding requirement is driven by the increase in the revenue requirement.

WEIM administrative charges are projected to increase to \$15.3 million in 2023 due to increased participation in the market. The WEIM currently has nineteen participating members in ten western states and produced over \$2.9 billion dollars in gross benefits since its launch in November 2014. New participants scheduled for 2023 include Avangrid, El Paso Electric, and WAPA Desert Southwest Region.

Forecasting fees are projected to increase to \$5.5 million as additional WEIM entities onboard and as indicated by prior years’ trends.

All other components of this category are projected to see little to no change in 2023.

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 2023, the operating cost reserve credit adjustment of \$16.8 million is based on the trued-up activity from 2021.

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)	2023 Budget	2022 Budget	Change
Change in the 15% reserve for O&M budget	(\$4.2)	(\$1.5)	(\$2.7)
25% debt service collection from prior year	2.9	3.4	(0.5)
True-up of budget to actual revenues and expenses	18.0	17.2	0.8
Total Operating Cost Reserve Credit / (Debit)	\$16.8	\$19.1	(\$2.3)

Grid Management Charge Rates, Fees, and Charges

The 2023 forecasted grid management charges and supplemental service rates will increase in comparison to 2022 due to the amount of net revenue requirement to collect.

A comparison of the proposed 2023 rates and the current 2022 rates is as follows (\$ per unit):

Charge Code	Summary of Charges, Fees, and Rates	2023 Rate	2022 Rate	Change \$	Billing Unit
Grid Management Charges					
4560	Market Service Charge	\$0.1513	\$0.1265	\$0.0248	per MWh
4561	Systems Operations Charge	\$0.2167	\$0.1700	\$0.0467	per MWh
4562	CRR Services Charge	\$0.0071	\$0.0055	\$0.0016	per MWh
Miscellaneous Fixed Fees					
701	EIR Forecast Fee	\$0.1000	\$0.1000	\$0.0000	per MWh
4512	Inter-SC Trade Fees	\$1.00	\$1.00	\$0	per # of trades
4515	Bid Segment Fees	\$0.0050	\$0.0050	\$0.0000	per # of bid segments
4516	CRR Auction Bid Fees	\$1.00	\$1.00	\$0.0000	per # of nominations and
4563	TOR Fees	\$0.1800	\$0.1800	\$0.0000	per MWh
4575	SCID Fees (monthly)	\$1,500	\$1,500	\$0	per # of SCID
Supplemental Services Rates					
4564	WEIM Market Service	\$0.0953	\$0.0797	\$0.0156	per MWh
4564	WEIM System Operations	\$0.1084	\$0.0850	\$0.0234	per MWh
5701	RC Service Rate	\$0.0305	\$0.0278	\$0.0027	per MWh

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 inquiries into and / or clarifying scope and budget questions regarding current projects and planned projects. The general consensus was the stakeholders were supportive of the GMC revenue requirement. With Board approval, the ISO will post the proposed GMC rates on its website to be effective on January 1, 2023.

It should be noted that post-decision minor adjustments are sometimes required to align 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 2023 GMC revenue requirement will provide sufficient funding to enable the ISO to deliver on the commitments it made to achieve its Strategic Plan while still maintaining disciplined growth and rates for its stakeholders. Therefore, Management recommends that the ISO Board of Governors approve the GMC revenue requirement attached to this memorandum.