



# Memorandum

**To:** ISO Board of Governors and Western Energy Imbalance Market Governing Body

**From:** Anna McKenna, Vice President Market Design and Analysis

**Date:** September 13, 2023

**Re:** **Decision on 2023 Variable Operations and Maintenance Cost Review 2023**

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***This memorandum requires ISO Board of Governors and WEIM Governing Body action.***

## EXECUTIVE SUMMARY

Pursuant to the ISO business practice manuals, a review of the default variable operations and maintenance costs is performed every three years. As a result of the most recent triennial review of default variable operations and maintenance (VOM) cost adders, Management proposes to update the current default VOM adder values by applying an 18.73% inflation adjustment to all default values. This 18.73% inflation adjustment is based on data from the US Bureau of Labor Statistics (BLS) from June 2023 and is necessary to make a general adjustment to reflect the notable inflation experienced since the last comprehensive assessment of all aspects of the VOM costs in 2020. For this triennial review, Management is not proposing to make changes to other elements.

### ***ISO Board of Governors and WEIM Governing Body motion:***

***Moved, that the ISO Board of Governors and WEIM Governing Body approve the revision to the variable operations and maintenance cost adders as described in the memorandum dated September 13, 2023; and***

***Moved, that the ISO Board of Governors and the WEIM Governing Body authorize Management to make all necessary and appropriate filings with the Federal Energy Regulatory Commission to implement the change proposed in this memorandum, including any filings that implement the overarching initiative policy but contain discrete revisions to incorporate Commission guidance in any initial ruling on the proposed tariff amendment.***

## DISCUSSION AND ANALYSIS

Market participants submit multiple types of data to the ISO's day-ahead and real-time market systems to reflect a resources' operational capabilities and costs. Among these data submissions are resources' VOM costs which serve as an adder to market calculations such as default energy bids and commitment costs. Default VOM adders are codified in the tariff and reviewed every three years. However, if a market participant believes the default VOM adder is incorrect for their resource, they have the option to negotiate a VOM adder with the ISO.

VOM adders are a component of most resources' default energy bids. Default energy bids are used in the local market power mitigation process to limit the bids that the markets use in determining resource schedules when a resource is found to have the potential to exert market power. The default energy bids are constructed to reflect competitive outcomes absent the participant's ability to exercise local market power. In such cases, the ISO's market power mitigation process may adjust a resource's submitted energy bid downward to the resource's default energy bid or the competitive locational marginal price, whichever is higher.

VOM adders are also a component of resources' default commitment costs. Default commitment costs serve a similar purpose to default energy bids. However, instead of applying only when the potential for the exercise of market power exists, default commitment costs always serve as a cap on the values that scheduling coordinators may submit for minimum load cost bids, start-up cost bids, and transition cost bids. These bids are then used by the ISO's market processes to determine commitment of individual resources and for calculation of bid cost recovery settlements.

Default VOM adders are specified in the tariff and, in collaboration with stakeholders, reviewed every three years. The pre-determined value varies based on each resource's fuel and generation technology type (i.e., natural gas combined cycle gas turbine, hydroelectric, geothermal). The previous VOM cost review initiative that occurred in 2020 updated the default VOM adder values to an inflation reference year of 2019, which went into effect January 1, 2022, after some related work.

Given that three years have elapsed since that reference year, staff undertook this current review of the default VOM adder values. For the 2023 VOM cost review, several factors were evaluated: price inflation since the previous update to VOM adders; the frequency of VOM adder negotiations; and a review of additional sources including benchmarking to other ISO-RTOs.

Management has determined that an update is warranted due to the higher-than-normal inflation rates since 2019 levels were implemented in 2022. Specifically, Management proposes to update the default VOM adder values with an 18.73% inflation increase. This increase is based on the changes to the US BLS Consumer Price Index for all Urban Consumers from December 2019 to June 2023, as published in June 2023.

## **POSITIONS OF THE PARTIES**

Management appreciates the comments submitted by Salt River Project, the only stakeholder to submit comments, on the draft final proposal. Salt River Project pointed out that newer inflation figures had become available since the original proposal was posted. In response, the proposal uses updated June 2023 inflation reference point rather than December 2022, as originally proposed.

Salt River Project further requested that the ISO consider more frequent reviews of VOM adders. Salt River Project also suggested consideration of a methodology to forecast VOM costs. Management appreciates the need to keep default VOM adder values current. Management believes that the current market design mitigates the concerns arising from these two suggestions because it provides an option for a negotiated VOM adder in the case of rapid changes to these costs. Furthermore, despite recent higher-than-usual inflation, there was not a significant increase in market participant requests for the negotiated option. If there is a sudden increase in the negotiated option, Management will investigate the reasons for the increase and will consider whether there is a need for more frequent updates. Finally, Management is concerned with using forecasted costs because they would be dependent on inflation rates which are difficult to predict.

## **CONCLUSION**

Management recommends that the default VOM adders for each generation type be adjusted upward to reflect the 18.73% inflation since the last review of the default VOM cost adders.