

Memorandum

To: ISO Board of Governors
From: Nancy Saracino, Vice President, General Counsel & Chief Administrative Officer
Date: December 8, 2011
Re: **Decision on FY2012 Budget**

This memorandum requires Board action.

EXECUTIVE SUMMARY

This memorandum summarizes the proposed 2012 budget proposal that the Board is requested to approve. In this memorandum, the terms *budget* and *revenue requirement* are synonymous. The draft budget was posted to the California Independent System Operator Corporation's website for stakeholder review following the August Board meeting, and discussed at a stakeholder meeting on October 4.

The revenue requirement of \$194.8 million remains in the tight range that the ISO has maintained for the past six years. The budget is similar to the draft budget presented at the August board meeting except for the addition of \$1.5 million of forecasting costs for wind and solar resources, but which is offset by \$1.5 million in forecast fees collected from intermittent resources. The ISO is absorbing higher labor costs by continuing to achieve efficiencies in other non-labor costs, resulting in \$1.0 million of lower operating and maintenance (O&M) expenses before the forecasting costs. The O&M savings allow the ISO to increase the cash funded capital collected which helps ensure the long-term viability of the ISO.

Management recommends the following motion for the Board approval:

Moved, that the ISO Board of Governors approves the 2012 O&M and Capital/Project budgets as set forth in Attachment A to this memorandum dated December 8, 2011; and

Moved, the Board authorizes Management to take all necessary and appropriate actions to implement the 2012 grid management charge rates reflecting the 2012 budget.

DISCUSSION AND ANALYSIS

The annual revenue requirement is an integral component of the five-year planning process, and reflects the priorities and commitments made in the *Five-Year Strategic Plan*.

The 2012 revenue requirement is \$194.8 million. This amount is \$5.0 million higher than the 2011 revenue requirement and represents an increase of less than 1.7% over the past 5 years. Transmission volume is estimated to increase to 242.4 TWh, or a 1% increase from 2011. The bundled grid management charge is derived by dividing the revenue requirement by the forecasted transmission volume. The anticipated increase in volume combined with a higher revenue requirement will lead to a bundled grid management charge for 2012 of \$0.804 per MWh, a 1.6% increase (\$0.01) from 2011. The 2012 revenue requirement is below the \$197.0 million limit set in the 2011 rate extension. The revenue requirement has five components:

- Operating and maintenance (O&M) budget;
- Debt service;
- Cash funded capital budget;
- Miscellaneous revenue; and
- Operating reserve credit from 2011.

Operating and maintenance budget

The largest component of the revenue requirement is the operating and maintenance (O&M) budget, which for 2012 is proposed to be \$163.0 million, representing a \$500,000, or 0.3%, increase from 2011. The increase was attributable to an addition of \$1.5 million of forecasting costs for wind and solar resources. *Attachment 1* presents the O&M budget in three different perspectives: delivery of services (objectives and processes), utilization of resources, and divisional costs. ISO activities have been broken down into nine end-to-end core processes, which will be measured through activity-based costing.

Debt service

The debt service component of the 2012 revenue requirement will be \$46.3 million, which represents a \$2.6 million increase over 2011. The amount includes the net debt service amounts due, plus the required 25 % reserve, on the ISO's 2008 and 2009 bond issues.

- 2008 Bonds: \$197 million issued to refinance existing variable rate debt and to fund the development of the new market software. The collection for payments of the remaining 2008 bonds will be spread evenly over the 2012 and 2013 budgets. The 2008 bonds will be retired in 2014.

- 2009 Bonds: \$200 million issued to construct the Iron Point facility and other capital projects. The 30-year bond issue has level debt service payments due through 2039.

Capital/Project budget

The 2012 capital/project budget is proposed to be \$20.8 million, of which \$17.0 million will be funded from grid management charge funds and \$3.8 million from capital reserves. There is currently a prioritization underway that will result in the highest priority projects being proposed. The projects are then taken to the Corporate Management Committee for final decision.

Miscellaneous revenue

Miscellaneous revenue increased \$1.5 million over 2011 to \$8.4 million. The increase was attributable to forecast fees collected from intermittent resources of \$1.5 million. Other components of revenue were interest income of \$2.9 million, large generator interconnection studies of \$1.5 million, fees to operate the California Oregon Intertie of \$2.0 million, and other fees and charges of \$500,000.

Operating reserve credit from 2011

The reserve credit is primarily the cumulative result of the actual results versus the budgeted revenue requirement for the prior year. The revenue requirement includes a \$23.1 million operating reserve credit, which is \$9.9 million lower than 2011.

Grid management charges

The ISO recovers its costs through separate grid management charges to market participants. A new rate design for 2012 was developed with stakeholders, approved by the Board at its May 2011 meeting, filed with the Federal Energy Regulatory Commission, and approved without change on September 30, 2011. The new design provides for three service categories and five associated fees and charges. The rate is derived by dividing the recoverable costs for the category by the estimated billing determinants.

CRR application fee

Currently there is no charge to become a new congestion revenue rights participant. Effective January 1, 2012, a non-refundable fee of \$1,000 will be applied for applicants who are not already scheduling coordinators.

Budget process

The ISO has provided several opportunities for public review and comment on the draft budget. This public input process commenced with a June 16 budget kickoff call with

stakeholders and a stakeholder workshop on October 4. The ISO posted notes from the meetings on its website. Stakeholders also had the opportunity to present comments on the draft budget to the Board at the October 27-28 meeting but none were made. The ISO will subsequently post the GMC rates on its website to be effective on January 1, 2012.

It should be noted that minor adjustments are sometimes required to line items within the operations and maintenance budget due to final year-end headcount and consultant numbers. These year-end adjustments will not affect the final total approved budget.

Conclusion

The proposed revenue requirement will provide funding for the ISO and enable the delivery on the commitments made in the *Five-Year Strategic Plan* while still reducing the costs to our customers. Therefore, Management recommends that the Board approve the budget attached to this memorandum.