Memorandum

To: ISO Board of Governors

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

Date: December 11, 2024

Re: **Decision on 2025 budget**

This memorandum requires ISO Board of Governors action.

This memorandum summarizes the final 2025 grid management charge (GMC) revenue requirement proposal that the ISO Board of Governors is requested to approve and which will become effective January 1, 2025. 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 2025 Budget and Grid Management Charge Rates book, included as *Attachment A*.

At $238.5 million, the proposed 2025 GMC revenue requirement is $36.6 million higher than the 2024 GMC revenue requirement. The primary driver of the growth is the increase in the operations and maintenance (O&M) budget component of the revenue requirement. The 2025 O&M budget is 8% higher than 2024 primarily due to higher labor costs driven by inflationary pressures and funding for 18 new positions intended to address strain points within the organization. Another driver of the increase is cash-funded capital; the ISO proposes to increase the collection of cash-funded capital from $8 million in 2024 to $25 million in 2025. The ISO will offset some of the operating cost and cash-funded capital increases through continued growth in the other revenue categories and a moderate return of funds through the operating reserve credit.

Management recommends the following motion:

> ***Moved, that the ISO Board of Governors approves the 2025 GMC revenue requirement, project budget, and resulting rates as set forth in Attachment A to the memorandum dated December 11, 2024.***

DISCUSSION AND ANALYSIS

The annual GMC revenue requirement is a fundamental component of the ISO's planning process and reflects the priorities and commitments made in the ISO's Strategic Plan. For 2025, the proposed GMC revenue requirement, at $238.5 million, is $6.5 million beneath the FERC approved $245 million cap. The ISO's outlook indicates that in 2025, transmission volumes are expected to reach 248 TWh, marking a 2% increase compared to the projected volumes for 2024, which results in a pro-forma bundled cost per megawatt-hour (MWh) of $0.96, or an increase of $0.13 per MWh from 2024. This increase in the pro-forma bundled rate for 2025, despite higher projected transmission volumes, is attributed to the increase in the GMC revenue requirement.

The 2025 GMC revenue requirement was developed using the most recent Cost-of-Service Study results. The ISO completed its scheduled triennial study in 2023 in accordance with its tariff. The updated cost percentage allocations and fees, as a result of the Cost-of-Service Study, will be used to develop the 2024 through 2026 GMC revenue requirement and resulting charges.

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 2025 GMC revenue requirement compared to 2024 is as follows.

GMC Revenue Requirement ($ in millions)	**2025 Budget**	**2024 Budget**	**Change**	**Change %**
Operations & Maintenance Budget	$276.0	$255.7	$20.3	8%
Debt Service (including 25% reserve)	14.7	14.7	0.0	0%
Cash Funded Capital	25.0	8.0	17.0	213%
Other Costs and Revenues	(68.6)	(63.6)	(5.0)	8%
Operating Cost Reserve Adjustment	(8.6)	(12.9)	4.3	-33%
Total GMC Revenue Requirement	**$238.5**	**$201.9**	**$36.6**	**18%**
Transmission Volume Estimate in TWh	248.0	242.5	5.5	2%
Pro-forma bundled cost per MWh	**$0.96**	**$0.83**	**$ 0.13**	**16%**

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 2025 proposed O&M budget is $276 million, representing a $20.3 million increase over 2024. The 2025 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 2025 O&M budget by resource compared to 2024 is as follows.

- The salaries and benefits category will increase primarily due to 18 additional positions, merit increases and other compensation increases. These increases are slightly offset by a 4% vacancy discount rate.

- The occupancy costs and equipment category will increase slightly driven by utility rates, fees, and tax increases.

- The telecommunications and hardware and software maintenance category will increase primarily due to higher telecommunication rates for select services; as well as, to support additional servers, data storage devices, and market applications.

- The consultants and contract staff category will increase due to need for additional consulting needs to support studies and projects that have transitioned to a maintenance phase; and additional contract staff for short-term staff augmentation, training program development support, and other contracted maintenance services.

- The other contracts and professional fees category will increase due to two primary drivers: tools for interconnection processing and tools to support enhanced software development and data analysis. Additionally, the transition to subscription-based licenses and increased license counts for these applications continues.

  A large component of the other contracts resource category is for forecasting costs. Intermittent resources pay a forecasting fee to ISO of $0.10 per MWh of generation. These fees, collected from the variable resources, are included in the other costs and revenues component of the GMC revenue requirement to offset the related forecasting costs. Such fees are projected to bring in $6.5 million in revenue in 2025. In addition, ISO is currently finalizing a grant through the Department of Energy to help offset some of the costs incurred for new interconnection processing tools.

- The travel, training and other costs category will increase primarily due to higher anticipated meeting cost needs and insurance premium increases.

Debt Service

The debt service component of the 2025 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. There is $139.1 million in principal remaining to be collected as part of future revenue requirements thru 2039.

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)	**2025 Budget**	**2024 Budget**	**Change**
Principal payments	$8.9	$8.8	$0.1
Interest payments	2.8	2.9	(0.1)
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**

Cash-Funded Capital and Project Budget

The 2025 cash-funded capital component of the GMC revenue requirement is $25 million. The project budget is $30 million to fund projects such as those detailed in *Attachment A*; the $5 million difference between the amount collected in the GMC revenue requirement and the project budget will come from the cash-funded capital reserves. 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 proposed projects listed in *Attachment A* will continue to be prioritized through 2025 under the ISO's project approval process.

Other Costs and Revenues

Other costs and revenue will increase by $5 million to $68.6 million, primarily due to growth in the reliability coordinator (RC) funding requirement and western energy imbalance market (WEIM) administrative charges offset by projected lower interest earnings. 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 serve its needs.

A summary of other costs and revenues is as follows.

Other Costs and Revenue ($ in millions)	**2025 Budget**	**2024 Budget**	**Change**
Reliability Coordinator Funding Requirement	$20.7	$17.6	$3.1
Western Energy Imbalance Market Administrative Charges	18.4	15.6	2.8
Nodal Pricing Model Fee	9.2	9.2	-
Interest Earnings	8.0	9.0	(1.0)
Intermittent Resource (wind and solar) Forecasting Fees	6.5	6.5	-
Generation Interconnection Project Fees	3.0	3.0	-
Other Revenue	2.8	2.7	0.1
Total Other Costs and Revenue	**$68.6**	**$63.6**	**$5.0**

The 2025 RC funding requirement, calculated at $20.7 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 by applying the RC funding percentage, 8% per the results of the 2023 Cost-of-Service Study, to the revenue requirement. The resulting RC funding requirement for 2025 is $3.1 million higher than 2024 driven by the growth in the 2025 revenue requirement.

WEIM administrative charges are projected to increase to $18.4 million in 2025 primarily driven by the increase in the GMC rates. As of October 2024, the WEIM currently has twenty-two participating members in eleven western states and produced over $6.25 billion dollars in gross benefits since its launch in November 2014.

All other components of this category are projected to see little to no change in 2025

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 2025, the operating cost reserve credit adjustment of $8.6 million is based on the trued-up activity from 2023.

As with other revenue, this credit adjustment helps bring the revenue requirement below the FERC approved revenue requirement cap.

A summary of the operating reserve adjustment is as follows.

Operating Cost Reserve Adjustment ($ in millions)	2025 Budget	2024 Budget	Change
Change in the 15% reserve for O&M budget	($3.0)	($2.6)	($0.4)
25% debt service collection from prior year	2.9	2.9	0.0
True-up of budget to actual revenues and expenses	8.7	12.6	(3.9)
Total Operating Cost Reserve Credit / (Debit)	**$8.6**	**$12.9**	**($4.3)**

Grid Management Charge Rates, Fees, and Charges

The 2025 forecasted grid management charges (GMC) and supplemental service rates will increase in comparison to 2024. The rate increases are driven by the higher GMC revenue requirement.

A comparison of the proposed 2025 rates and the 2024 rates is as follows ($ per unit).

Charge Code	Summary of Charges, Fees, and Rates	2025 Rate	2024 Rate	Change	Billing Unit
	Grid Management Charges				
4560	Market Service Charge	$0.1615	$0.1376	$0.0239	per MWh
4561	Systems Operations	$0.2391	$0.2127	$0.0264	per MWh
4562	CRR Services Charge	$0.0079	$0.0069	$0.0010	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 Charge	$0.3250	$0.3250	$0.0000	per MWh
4575	SCID Fees (monthly)	$1,500	$1,500	$0	per # of SCID
	Supplemental Services Rates				
4564	WEIM Market Service	$0.1042	$0.0888	$0.0154	per MWh
4564	WEIM System Operations	$0.1004	$0.0893	$0.0111	per MWh
5701	RC Service Rate	$0.0320	$0.0278	$0.0042	per MWh

Budget Process

The ISO has provided several opportunities for public review and comment on the budget and development process. This public input process commenced with an August kickoff meeting with stakeholders and followed with a stakeholder call held in November. There were two stakeholder questions submitted as a result of the meetings. The questions were focused on project inquiries, calculation of the RC funding requirement, and the extended day-ahead market impacts to the budget and rates. The general consensus, taken from the meetings, was the stakeholders were supportive of the GMC revenue requirement. The ISO posted materials from the meetings on its website. With ISO Board of Governors approval of the proposed 2025 GMC revenue requirement, the ISO will post the proposed GMC rates on its website to be effective on January 1, 2025.

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 2025 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.