



Memorandum

To: ISO Board of Governors

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

Date: December 6, 2023

Re: **Decision on 2024 budget**

This memorandum requires ISO Board of Governors action.

This memorandum summarizes the final 2024 grid management charge (GMC) revenue requirement proposal that the ISO Board of Governors is requested to approve and which will become effective January 1, 2024. 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 2024 Budget and Grid Management Charge Rates book, included as *Attachment A*.

At \$201.9 million, the proposed 2024 GMC revenue requirement is \$2.2 million higher than the 2023 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 2024 O&M budget is 7% higher than 2023 primarily due to higher labor costs driven by inflationary pressures and funding for 13 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 2024 GMC revenue requirement, capital project budget, and resulting rates as set forth in Attachment A to the memorandum dated December 6, 2023.

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 2024, the proposed GMC revenue requirement, at \$201.9 million, is just shy of the FERC approved \$202 million cap. The ISO's outlook indicates that in 2024, transmission volumes are expected to reach 242.5 TWh, marking a 4% increase

compared to the projected volumes for 2023, which results in a pro-forma bundled cost per megawatt-hour (MWh) of \$0.83, or a decrease \$0.02 per MWh from 2023. This reduction in the pro-forma bundled rate for 2024, despite a higher GMC revenue requirement, is attributed to the expected growth in electrification of the grid, leading to additional projected volumes.

The 2024 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 study used activity-based costing to analyze cost and time data from 2022 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, will be used to develop the 2024 through 2026 GMC revenue requirement and resulting charges. The updated cost category percentages are used to allocate the revenue requirement to the market services, system operations, and congestion revenue rights (CRR) services funding requirements as part of the rate calculation process. The study results are also used to update the WEIM cost category percentages and the 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 2024 GMC revenue requirement compared to 2023 is as follows.

GMC Revenue Requirement (\$ in millions)	2024 Budget	2023 Budget	Change	Change %
Operations & Maintenance Budget	\$255.7	\$238.4	\$17.3	7%
Debt Service (including 25% reserve)	14.7	14.7	0.0	0%
Cash Funded Capital	8.0	21.0	(13.0)	-62%
Other Costs and Revenues	(63.6)	(57.6)	(6.0)	10%
Operating Costs Reserve Adjustment	(12.9)	(16.8)	3.9	-23%
Total GMC Revenue Requirement	\$201.9	\$199.7	\$2.2	1%
Transmission Volume Estimate in TWh	242.5	234.2	8.3	4%
Pro-forma bundled cost per MWh	\$ 0.83	\$ 0.85	\$ (0.02)	-2%

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 2024 proposed O&M budget is \$255.7 million, representing a \$17.3 million increase over 2023. The 2024 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 2024 O&M budget by resource compared to 2023 is as follows.

- The salaries and benefits category will increase primarily due to 13 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 increase slightly driven by a planned mobile device refresh and inflationary increases.
- The telecommunications and hardware and software maintenance category will increase primarily to support the maintenance needs of additional servers 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, interconnection integration, training, day-ahead-market studies, technology and operations applications ongoing efforts, and the need for subject matter experts in various fields such as renewable integration and energy markets.
- The other contracts and professional fees category will increase due to additional tools to support enhanced information security and forecasting data subscriptions. Additionally, the transition to subscription-based licenses and increased license counts for these applications continues. This increase was slightly offset by a reduction in the outside legal services budget.
- 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 2024 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 \$148 million in principal remaining to be collected as part of the 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)	2024 Budget	2023 Budget	Change
Principal payments	\$8.8	\$8.7	\$0.1
Interest payments	2.9	3.0	(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 Capital Project Budget

The 2024 cash-funded capital component of the GMC revenue requirement is \$8 million and the capital project budget is \$25 million to fund projects. The ISO will leverage its capital reserve to fund the \$17 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 2024 under the ISO's capital project approval process.

Other Costs and Revenues

Other costs and revenue will increase by \$6 million to \$63.6 million, primarily due to higher projected interest earnings driven by favorable interest rates. 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)	2024 Budget	2023 Budget	Change
Reliability Coordinator Funding Requirement	\$17.6	\$19.7	(\$2.1)
Western Energy Imbalance Market Administrative Charges	15.6	15.3	0.3
Nodal Pricing Model Fee	9.2	8.4	0.8
Interest Earnings	9.0	4.0	5.0
Intermittent Resource (wind and solar) Forecasting Fees	6.5	5.5	1.0
Generation Interconnection Project Fees	3.0	2.0	1.0
Other Revenue	2.7	2.7	-
Total Other Costs and Revenue	\$63.6	\$57.6	\$6.0

The 2024 RC funding requirement, calculated at \$17.6 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 RC funding percentage is one of the cost category percentages analyzed in the triennial Cost-of-Service Study. The results of the 2023 Cost-of-Service Study indicated a slight reduction to the RC funding percentage was necessary; the funding percentage was reduced from 9% to 8%.

WEIM administrative charges are projected to increase to \$15.6 million in 2024 primarily driven by full participation of the WEIM entities that joined in 2023. As of September 2023, the WEIM currently has twenty-two participating members in eleven western states and produced over \$4.66 billion dollars in gross benefits since its launch in November 2014.

The nodal pricing model fee is set to increase from \$8.4 million to \$9.2 million, with the increase being in line with inflation and other factors influencing costs since the initial fee was established.

Forecasting fees are projected to increase to \$6.5 million driven by WEIM entities' forecasting needs.

Anticipated generator interconnection projects in 2024 are expected to lead to a rise in generator interconnection project fees, with a projected revenue increase to \$3 million.

All other components of this category are projected to see little to no change in 2024.

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 2024, the operating cost reserve credit adjustment of \$12.9 million is based on the trued-up activity from 2022.

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)	2024 Budget	2023 Budget	Change
Change in the 15% reserve for O&M budget	(\$2.6)	(\$4.2)	\$1.6
25% debt service collection from prior year	2.9	2.9	0.0
True-up of budget to actual revenues and expenses	12.6	18.1	(5.5)
Total Operating Cost Reserve Credit / (Debit)	\$12.9	\$16.8	(\$3.9)

Grid Management Charge Rates, Fees, and Charges

The 2024 forecasted grid management charges and supplemental service rates will decrease in comparison to 2024. This reduction in the rates for 2024, despite a higher GMC revenue requirement, is attributed to the expected growth in volumes.

A comparison of the proposed 2024 rates and the current 2023 rates is as follows (\$ per unit).

Charge Code	Summary of Charges, Fees, and Rates	2024 Rate	2023 Rate	Change	Billing Unit
Grid Management Charges					
4560	Market Service Charge	\$0.1376	\$0.1513	(\$0.0137)	per MWh
4561	Systems Operations Charge	\$0.2127	\$0.2167	(\$0.0040)	per MWh
4562	CRR Services Charge	\$0.0069	\$0.0071	(\$0.0002)	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	\$0.1800	\$0.1450	per MWh
4575	SCID Fees (monthly)	\$1,500	\$1,500	\$0	per # of SCID
Supplemental Services Rates					
4564	WEIM Market Service	\$0.0888	\$0.0953	(\$0.0066)	per MWh
4564	WEIM System Operations	\$0.0893	\$0.1084	(\$0.0190)	per MWh
5701	RC Service Rate	\$0.0270	\$0.0278	(\$0.0008)	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 October. The ISO posted materials from the meetings on its website. There were no stakeholder comments submitted. The general consensus, taken from the meetings, was the stakeholders were supportive of the GMC revenue requirement. With ISO Board of Governors approval of the proposed 2024 GMC revenue requirement, the ISO will post the proposed GMC rates on its website to be effective on January 1, 2024.

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 2024 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.