

NYISO 2006 DRAFT BUDGET

**Budget, Standards & Performance Subcommittee
As Previously Presented To Management
Committee on
October 11, 2005**

NYISO 2006 DRAFT BUDGET

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NYISO 2006 DRAFT BUDGET: **SCHEDULE**

- September 27: BSP subcommittee review of draft 2006 budget
- October 11: BSP presents draft 2006 budget to Management Committee for review
- October 14: NYISO presents draft 2006 budget to BOD Finance Committee for review
- October 24: BSP meeting to discuss feedback received from Management Committee and BOD Finance Committee
- November 9: Management Committee vote on final 2006 budget for recommendation to BOD Finance Committee
- November 15: BOD Finance Committee approval of final 2006 budget

NYISO 2006 DRAFT BUDGET

Highlights

THEMES:

- *Within Budget Target:* Draft 2006 budget is within the budget target established in 2003 (despite certain costs exceeding inflationary increases);
- *Overall Focus:* Like 2005, 2006 will continue NYISO's focus on Excellence in Execution initiatives;
- *RTO Cost Consciousness:* NYISO's annual spending levels reflect a decrease from 2005 (excluding FERC Fees)

MAIN 2006 PRIORITIES:

- Elimination of pricing errors (using existing resources / budget)
- Eliminate backlog of most final bill closeout invoices by July 2006
- Continue TCC and UCAP automation / enhancement initiatives
- Continue automation efforts for manual billing processes
- Begin process to replace Billing & Accounting System
- Begin process to replace Market Information System
- Begin to realize effectiveness and efficiencies from Lean Six Sigma quality initiative
- Continue transition plan to migrate to new headquarters facility (expected completion is Q1 2007)

NYISO 2006 DRAFT BUDGET

Summary Budget

<u>Cost Category</u> <i>(\$ in millions, excluding RS#1/MWH)</i>	<u>2006 Draft</u>	<u>2005 Budget</u>	<u>2004 Actuals</u>	<u>2003 Actuals</u>
Current Year Needs (excl. FERC Fees)	\$130.0	\$130.5	\$132.1	\$139.8
Plus: Debt Service from Prior Year Financings	<u>\$31.5</u>	<u>\$26.5</u>	<u>\$29.0</u>	<u>\$15.9</u>
Cash Budget	\$161.5	\$157.0	\$161.1	\$155.7
Less: Miscellaneous Revenues	(\$2.5)	(\$1.9)	(\$1.1)	(\$1.0)
Less: Net Proceeds on Current Year Financings	<u>(\$35.8)</u>	<u>(\$33.1)</u>	<u>(\$41.5)</u>	<u>(\$45.8)</u>
Net Budget Needs – in \$\$	\$123.2	\$122.0	\$118.5	\$108.9
FERC Fees – in \$\$	<u>\$9.9</u>	<u>\$7.0</u>	<u>\$5.3</u>	<u>\$7.9</u>
Total RS#1 Rev. Requirement – in \$\$	\$133.1	\$129.0	\$123.8	\$116.8
Net Budget Needs – in \$/MWH	\$0.742	\$0.745	\$0.736	\$0.686
FERC Fees – in \$/MWH	<u>\$0.060</u>	<u>\$0.043</u>	<u>\$0.033</u>	<u>\$0.050</u>
Total RS#1 Rev. Requirement - \$/MWH	\$0.802	\$0.788	\$0.769	\$0.736
RS#1 Charge/MWH: Purchasers @ 80% (85% pre-2005)	\$0.642	\$0.630	\$0.654	\$0.626
RS#1 Charge/MWH: Sellers @ 20% (15% pre-2005)	\$0.160	\$0.158	\$0.115	\$0.110

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Detail Budget by Cost Category

<i>(\$ in millions, except RS#1/MWH)</i>	<u>2006 Draft</u>	<u>2005 Budget</u>	<u>2004 Actuals</u>	<u>2003 Actuals</u>
Capital	\$22.4	\$21.8	\$12.1	\$30.3
Salaries & Benefits	50.3	47.4	42.1	37.6
Professional Fees (including Legal)	26.6	29.2	49.2	49.2
Building Services	4.4	4.2	4.2	3.3
Computer Services	10.5	11.5	8.7	4.2
Insurance	4.6	6.8	6.4	6.7
Telecommunications	5.1	4.2	4.5	3.1
Other Expenses (BOD, Travel/Training, NPCC Fees)	6.1	5.4	4.9	5.4
Current Year Needs (excl. FERC Fees)	\$130.0	\$130.5	\$132.1	\$139.8
Debt Service	<u>31.5</u>	<u>26.5</u>	<u>29.0</u>	<u>15.9</u>
Cash Budget	\$161.5	\$157.0	\$161.1	\$155.7
Less: Miscellaneous Revenues	(2.5)	(1.9)	(1.1)	(1.0)
Less: Proceeds from Current Year Budget Debt	(28.0)	(20.4)	(42.0)	(47.0)
Less: Proceeds from Mortgage/Renovations Debt	(9.0)	(15.9)	-	-
Add: Interest on Current Year Budget Debt	0.8	0.5	0.5	1.2
Add: Principal & Interest on Mortgage/Renovations Debt	<u>0.4</u>	<u>2.7</u>	-	-
Net Budget Needs	\$123.2	\$122.0	\$118.5	\$108.9
FERC Fees	9.9	7.0	5.3	7.9
Rate Schedule #1 Revenue Requirement in \$\$	\$133.1	\$129.0	\$123.8	\$116.8
MWH Hours	166.0	163.7	161.0	158.8
Rate Schedule #1 Revenue Requirement in \$/MWH	\$0.802	\$0.788	\$0.769	\$0.736

NYISO 2006 DRAFT BUDGET

Summary of Significant Changes

2005 Net Budget Needs		\$130.5
➤ <u>Less: Efficiencies and reductions</u>		(4.6)
Elimination of credit insurance program	(\$1.7)	
Reduction in use of consultants	(\$1.4)	
Savings on HW & SW maintenance/licenses	(\$1.0)	
Savings on annual insurance premiums	(\$0.5)	
➤ <u>Plus: Budget increases</u>		4.1
Net increase in staffing (FTEs and contractors)	\$1.2	
Increase in telecommunication costs	\$0.9	
Increase in annual Capital acquisitions	\$0.6	
Increase in external legal costs	\$0.5	
Increase in misc. other costs	\$0.9	
➤ <u>Subtotal: Decrease in Net Budget Needs</u>		<u>(\$0.5)</u>
Equals: 2006 Net Budget Needs		\$130.0

NYISO 2006 DRAFT BUDGET

Line Item Details - CAPITAL

(\$ in millions)	<u>2006 Draft</u>	<u>2005 Budget</u>	<u>\$ Change</u>
Acquisition and Renovation of New Headquarters Facility	\$11.6	\$15.9	(\$4.3)
Replacement of Existing Hardware	\$4.8	\$1.2	\$3.6
Additional Hardware/Software for Product Enhancements	\$3.0	\$0.1	\$2.9
Additional Software Licenses (capitalized)	\$2.4	\$2.4	\$ -
Renovations to Power Control Center	\$0.6	\$2.1	(\$1.5)
Replacement of Existing Furniture	\$ -	<u>\$0.1</u>	(\$0.1)
Total Capital Costs	\$22.4	\$21.8	\$0.6

Acquisition and Renovation of New Headquarters Facility:

Such costs are being financed over a 20-year term, and are reflected as part of the Capital line item, although a corresponding offset to RS#1 occurs in the Proceeds from Debt portion of the RS#1 Revenue Requirement calculation.

Replacement of Existing Hardware:

To maintain current technology, NYISO's strategy is to replace existing hardware every three years. The 2006 level of capital spending on upgrading existing hardware is consistent with historical levels. The 2005 budget is low in comparison to such levels as NYISO was limited in space and power capacity for hardware during 2005.

Hardware/Software for Product Enhancements:

None of the product enhancements during 2005 required a capital investment. During 2006, NYISO anticipates beginning the process to replace the BAS and MIS systems. Funds reserved in the 2006 Capital budget are primarily designated for such initiatives.

Renovations to Power Control Center:

NYISO's prioritization of required capital improvements to the PCC facility has resulted in a lower annual amount of spending than originally anticipated when the 2005 budget was prepared. While \$2.1M was earmarked in the 2005 budget for such improvements, the anticipated level of spending for 2005 is ~\$1M. Certain improvements not completed during 2005 (those lower in priority) will occur in 2006 and beyond.

NYISO 2006 DRAFT BUDGET

Line Item Details – SALARIES & BENEFITS

HEADCOUNT SUMMARY	FTEs
12/31/05 Budgeted Totals	411
Staff Changes in 2005	<u>12</u>
12/31/05 Projected Totals	423
Staff Changes in 2006	-
12/31/06 Totals	423

<i>(\$ in millions)</i>	2006 Draft	2005 Budget	\$ Change
Salaries	\$35.4	\$32.9	\$2.5
Incentive Bonuses	\$5.0	\$4.6	\$0.4
Payroll Taxes	\$2.8	\$2.6	\$0.2
Benefit Programs	<u>\$7.1</u>	<u>\$7.3</u>	<u>(\$0.2)</u>
Total Salaries & Benefits	\$50.3	\$47.4	\$2.9
<p><i>The 6% increase in Salaries & Benefits is primarily due to the following:</i></p> <ul style="list-style-type: none"> * Full year cost of additional positions created; * Annual salary increases of ~4% ; * Offset by: reduction in expected annual increases for Medical insurance <p><i>NOTE: The 6% increase is less than half of the annual increase in Salaries & Benefits noted from 2003 – 2005. NYISO does not intend to add any headcount during 2006 or during the 2007 -2010 period.</i></p>			

NYISO 2006 DRAFT BUDGET

Line Item Details – DEBT SERVICE

Major Assumptions:

- \$25M will be borrowed in 2006 to fund capital acquisitions and product enhancements
- \$12M will be borrowed in 2006 to complete the renovations and migration to the Phoenix building (\$9M for renovations is borrowed over a 20-year term and \$3M for migration costs/furniture is borrowed over a 5-year term)
- Interest on the 20-year term renovations is fixed at 5.96%
- Interest on most of the 5-year borrowings for capital acquisitions/product enhancements and Phoenix migration is capped at 4.80%

ANNUAL PRINCIPAL AND INTEREST REPAYMENTS **									
(\$ in millions)									
<u>Debt Facility</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
2003 Budget Loan	\$13.1	\$12.7	\$12.0	\$2.0	\$ -	\$ -	\$ -	\$ -	\$ -
2004 Budget Loan	12.0	11.7	11.2	10.7	-	-	-	-	-
2005 Phoenix Bldg Mortgage & Renov.	2.5	1.2	1.5	1.7	2.1	2.1	2.1	2.1	2.1
2005 Budget Loan	0.5	5.5	5.3	5.0	4.8	-	-	-	-
2006 Budget Loan	-	0.8	8.2	7.8	7.5	7.2	-	-	-
Bank Fees	0.8	0.8	0.7	0.7	0.7	0.7	TBD	TBD	TBD
Total	\$28.9	\$32.7	**	**	**	**	**	**	**

** Note: Totals after 2006 are not presented as additional loans after 2006 are factored into this table.

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Line Item Details – FERC FEES

- NYISO includes FERC Fees within its annual RS#1 budget revenue requirements. Other ISOs do not utilize this practice and instead, assess FERC Fees as a direct passthrough to MPs.
- NYISO (and other ISOs) have protested to FERC both the level of FERC Fees and the methodology for assessing FERC Fees. A recent calculation indicated that ISOs & RTOs pay ~70% of the overall FERC annual budget.
- FERC Fees (and the potential for continued significant annual increases) are the primary item causing significant pressure on NYISO's ability to meet budget targets and to maintain reasonable annual budget increases. The level of FERC Fees is presented to the right:

NYISO History of FERC Fees					
(\$ in millions)	2002	2003	2004	2005	2006
Annual Budget	\$5.0	\$5.0	\$8.0	\$7.0	\$9.9
FERC Annual Assessment	\$6.2	\$7.7	\$6.7	\$8.3	TBD
FERC Adj. to Prior Year	\$ -	\$0.2	(\$1.4)	\$0.3	TBD
Total Annual FERC Fees	\$6.2	\$7.7	\$5.3	\$8.6	TBD
% Change in FERC Fees	n/a	24%	(31%)	62%	TBD

Other ISOs History of FERC Fees					
(\$ in millions)	2002	2003	2004	2005	2006
NYISO	\$6.2	\$7.7	\$5.3	\$8.6	TBD
CAISO	\$9.1	\$11.3	\$7.8	\$12.3	TBD
PJM	\$1.7	\$25.2	\$14.1	\$21.4	TBD
MISO	\$ -	\$1.4	\$30.0	\$30.0	TBD
ISO-NE	\$ -	\$ -	\$ -	\$ -	TBD

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Other ISOs Comparison

<i>(\$ in millions)</i>					
ISO/RTO	2006 Revenue Requirement	2006 FERC Fees	2006 Rev. Req. excluding FERC Fees	Debt Outstanding at 12/31/06	FTEs at 12/31/06
MISO	\$262.1	\$ -	\$262.1	\$406.5	670
PJM	TBD	\$ -	TBD	TBD	~575-600
CAISO	\$183.0	\$ -	\$183.0	\$169.0	528
ERCOT	\$124.9	\$ -	\$124.9	\$157.4	587
NYISO	\$133.1	\$9.9	\$123.2	\$99.3	423
ISO-NE	\$113.9	\$ -	\$113.9	\$87.1	417

NYISO 2007-2010 Budget Targets Highlights

- Process Used:
During the 2006 budget process, NYISO created detailed projections for 2007 – 2008 to determine the feasibility of meeting the existing budget targets for that period. NYISO also created detailed projections for 2009 – 2010 to allow the development of 2009 – 2010 budget targets.
- Comparison of 2007 – 2008 to Existing Targets:
NYISO's projections exceed the established budget targets by \$3.5M in 2007 and \$8.3M in 2008, respectively. While the cause of the 2008 "overrun" is partially caused by ~\$2M higher debt service costs than originally anticipated, the 2007 – 2008 predicament is primarily driven by higher than anticipated increases in FERC Fees. Despite the projected difficulty in meeting the 2007 – 2008 budget targets, NYISO still intends to establish annual budgets for 2007 – 2008 within the existing budget target levels. To help facilitate this, NYISO recommends changing the process used to handle variances on collections of MWHs under RS#1 – see further details on slide 17.
- Recommended Budget Targets for 2009 – 2010:
Primary goal of creating five-year budget targets is to create rate stability for MPs and to reflect minimal, if any, annual increases in RS#1. NYISO maintains that budget targets must be based on a set of assumptions and detailed projections. NYISO's projection for 2009 is slightly less than 2007, and represents a less than 5% increase from 2008. NYISO's projection for 2010 represents a 3.5% increase from 2009. Additionally, the increase in RS#1 from 2004 – 2010 (a seven-year period) is a total of 10%.
- Comparison to Other ISO Trends:
Certain other ISOs have stated that their annual budget requirements will remain flat or will decrease for a period of years. NYISO supports this culture of cost-consciousness, and is taking steps to reduce discretionary spending. However, comparisons of NYISO's budgets to other ISOs should include the following points:
 - * Other ISOs exclude FERC Fees from their budget requirements,
 - * Other ISOs do not make firm commitments for a five-year period (most include disclaimers for potential unforeseen events),
 - * The annual budget requirements, outstanding debt, number of FTEs, and start-up costs for most other ISOs exceed NYISO's.

NYISO 2007-2010 BUDGET TARGETS

Target Levels – Current Version

NYISO intends to create annual budgets for 2007 – 2008 that are within the RS#1 revenue requirement targets established in 2003. However, the components of the target levels for these years have been revised and are presented below. Proposed targets for 2009 and 2010 based on NYISO's detailed projections are also presented below:

<i>(\$ in millions, except RS#1/MWH)</i>	2004 Budget	2005 Budget	2006 Draft	2007 Target	2008 Target	2009 Target	2010 Target
Current Year Needs (excl. FERC Fees)	\$131.5	\$130.5	\$130.0	\$114.3	\$112.7	\$124.5	\$128.0
Debt Service (prior year financings)	<u>30.2</u>	<u>26.5</u>	<u>31.5</u>	<u>38.9</u>	<u>35.7</u>	<u>30.2</u>	<u>32.0</u>
Cash Budget	\$161.7	\$157.0	\$161.5	\$153.2	\$148.4	\$154.7	\$160.0
Less: Net proceeds on CY financings	(44.8)	(33.1)	(35.8)	(24.1)	(24.0)	(24.0)	(24.0)
Less: Misc. Revenues	<u>(1.1)</u>	<u>(1.9)</u>	<u>(2.5)</u>	<u>(1.8)</u>	<u>(1.9)</u>	<u>(1.9)</u>	<u>(1.9)</u>
Net Budget Needs	\$115.8	\$122.0	\$123.2	\$127.3	\$122.5	\$128.8	\$134.1
FERC Fees	<u>8.0</u>	<u>7.0</u>	<u>9.9</u>	<u>10.9</u>	<u>12.0</u>	<u>13.2</u>	<u>14.5</u>
RS#1 Revenue Requirement in \$\$	\$123.8	\$129.0	\$133.1	\$138.2	\$134.5	\$142.0	\$148.6
MWH	<u>161.0</u>	<u>163.7</u>	<u>166.0</u>	<u>168.5</u>	<u>171.0</u>	<u>173.1</u>	<u>175.0</u>
RS#1 Revenue Requirement in \$/MWH	\$0.769	\$0.788	\$0.802	\$0.821	\$0.787	\$0.820	\$0.849
Annual Change in RS#1/MWH	<u>3.9%</u>	<u>2.5%</u>	<u>1.8%</u>	<u>2.4%</u>	<u>(4.1%)</u>	<u>4.2%</u>	<u>3.5%</u>
<i>Source for RS#1 Revenue Requirement</i>	<i>Target Set in 2003</i>	<i>Target Set in 2003</i>	<i>Target Set in 2003</i>	<i>Target Set in 2003</i>	<i>Target Set in 2003</i>	<i>Detailed Projection by NYISO</i>	<i>Detailed Projection by NYISO</i>

NYISO 2007-2010 BUDGET TARGETS

Average Change over 2004 - 2010 Period

<i>(\$ in millions, except RS#1/MWH)</i>	2004 Budget	2005 Budget	2006 Draft	2007 Target	2008 Target	2009 Target	2010 Target	2004 - 2010 Total Change		
								\$	%	Avg. % Increase
Current Year Needs (excl. FERC Fees)	\$131.5	\$130.5	\$130.0	\$114.3	\$112.7	\$124.5	\$128.0	(\$3.5)	(2.7%)	(0.5%)
Cash Budget	\$161.7	\$157.0	\$161.5	\$153.2	\$148.4	\$154.7	\$160.0	(\$1.7)	(1.1%)	(0.2%)
Net Budget Needs	\$115.8	\$122.0	\$123.2	\$127.3	\$122.5	\$128.8	\$134.1	\$18.3	15.8%	2.6%
FERC Fees	\$8.0	\$7.0	\$9.9	\$10.9	\$12.0	\$13.2	\$14.5	\$6.5	81.3%	13.6%
RS#1 Revenue Requirement in \$\$	\$123.8	\$129.0	\$133.1	\$138.2	\$134.5	\$142.0	\$148.6	\$24.8	20.0%	3.3%

NYISO 2007-2010 BUDGET TARGETS

Debt Summary

PRINCIPAL BALANCE OUTSTANDING AT DECEMBER 31, (\$ in millions)									
Debt Facility	2005	2006	2007	2008	2009	2010	2011	2012	2013
2003 Budget Loan	\$25.5	\$13.7	\$2.0	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
2004 Budget Loan	31.5	21.0	10.5	-	-	-	-	-	-
2005 Phoenix Bldg Mortgage & Renov.	13.6	22.5	22.3	22.0	21.2	20.4	19.6	18.7	17.7
2005 Budget Loan	18.8	14.1	9.4	4.7	-	-	-	-	-
2006 Budget Loan	-	28.0	21.0	14.0	7.0	-	-	-	-
2007 Budget Loan	-	-	25.0	18.8	12.5	6.3	-	-	-
2008 Budget Loan	-	-	-	25.0	18.8	12.5	6.3	-	-
2009 Budget Loan	-	-	-	-	25.0	18.8	12.5	6.3	-
2010 Budget Loan	-	-	-	-	-	25.0	18.8	12.5	6.3
Total	\$89.4	\$99.3	\$90.2	\$84.5	\$84.5	\$83.0	**	**	**

*** Note: Totals for 2011 – 2013 are not presented as no additional loans that may occur after 2010 are factored into this table.*

NYISO 2007-2010 BUDGET TARGETS

Transactional Volume Considerations

BACKGROUND:

- As annual budgets are created, NYISO estimates expected MWHs to use in the denominator of the RS#1 calculation.
- Over or under-collections caused by variances between actual and forecasted MWH have been passed through to MPs (i.e. rebates or charges to MPs for over/under collections on MWHs).
- In 2003, Management Committee motion to approve budget allowed NYISO to utilize any spending underruns toward paying down existing debt (motion was silent with regard to variances on MWH volumes).
- NYISO is currently holding \$2M in over-collected funds from 2004, and ~\$4M in over-collections on 2005 MWHs through August.
- BSP has considered the possibility of establishing a budget reserve from over-collections on transactional volumes to assist with unforeseen expenditures in a given budget year. NYISO has cautioned that tracking by MP of such a reserve would be administratively burdensome.

STAFF PROPOSAL:

- NYISO recommends utilizing any over-collections (both those existing at 12/31/05 and on a going forward basis) from transactional volumes to pay down existing debt – consistent treatment with spending under-runs.
- NYISO will manage any annual under-collections on transactional volumes in conjunction with anticipated debt borrowings and/or annual spending under-runs – MPs will not be assessed an increase to RS#1 during a given budget year.
- NYISO will continue to report trends on transactional volumes to MPs during BSP meetings.

BS&P Budget Review

Based on the feedback provided at the 9/27/05 BS&P meeting and subsequent, the consensus of the participants:

- *Support approval of the Rate Schedule #1 Revenue Requirement budget of \$133.1M, as proposed, representing the funding level required to meet the ISO's key objectives while staying within the 2006 target budget.*
- *Continue support for 2007 & 2008 budget targets previously approved and for the 2003 motion that under-spent budget funds be applied toward debt, rather than refunded to Market Participants.*
- *Advocate approval of the ISO Staff proposal to utilize over-collections (existing at 12/31/05 and on a going forward basis) from transactional volumes to pay down existing debt.*
- *Support the process for developing 5- yr budget targets as part of the annual budget (Reaction to the 2009 and 2010 budget targets presented was mixed as some MP's expressed concerns about targets exceeding inflationary increases.)*
- *Recommend that ISO staff revisit the FERC fee issue and determine what actions (if any) should be taken to challenge the level of annual assessments.*

The BS&P has also requested the implementation of a reporting and feedback process with the BS&P relative to the Executive Incentive Compensation program (similar to the mechanism currently in place for the Corporate Incentive Program). This request is currently pending.