

Memorandum

To: ISO Board of Governors

From: Ryan Seghesio, Chief Financial Officer & Treasurer

Date: July 5, 2012

Re: Decision on 2012 Capital Project Budget Amendment

This memorandum requires Board action.

EXECUTIVE SUMMARY

As part of the annual budget process, in addition to the operations and maintenance budget, the Board approves a targeted level of capital expenditures that the ISO will spend in the budget year. The 2012 capital expenditure budget was approved at a level of \$20.8 million. Management recommends an increase of \$3.6 million due to the unplanned projects described in this memo. As further explained, this amendment will have no impact on current grid management charge rates. Management recommends the Board approve the following motion:

Moved, that the ISO Board of Governors authorizes an increase to the 2012 capital project budget of \$3.6 million for a total 2012 capital project budget of \$24.4 million, as described in the memorandum dated July 5, 2012.

DISCUSSION AND ANALYSIS

During the 2012 budget process, the Board approved a targeted level of capital expenditures during the year of \$20.8 million. Approximately \$35 million of proposed projects were scrutinized and ranked to develop the initial list of projects that would make up the \$20.8 million. These projects are further reviewed and prioritized by Management throughout the year and ultimately approved by the Corporate Management Committee. Additionally, unplanned projects that must be completed, such as projects required to comply with FERC orders, compete for these resources.

Vendor contract

In June, during a Board meeting in executive session, the Board authorized Management to finalize negotiations on a vendor contract. The final cost of the capital project portion of the contract is approximately \$2.6 million. Because the ISO does not wish to delay or eliminate the projects that are being funded by the original capital budget amount of \$20.8 million for 2012, Management requests that the Board increase the capital budget to accommodate this additional project.

FERC Settlement – Constellation Energy

In March, FERC issued an order approving a stipulation and consent agreement between the Office of Enforcement and Constellation Energy Commodities Group (Docket No. IN12-7-000). In the order, FERC required Constellation Energy Commodities Group to pay \$1,000,000 to each of the RTOs and ISOs for the purpose of acquiring computer hardware and software that improves their respective surveillance and analytic capabilities. Management is still working with FERC's Director of the Office of Enforcement regarding the specific use of these funds, and the Board will be updated at a future meeting on that decision.

While the funding source for these capital expenditures is known, the targeted level of the capital project budget will need to be increased by \$1 million so the ISO has authorization to proceed with using its capital budget to improve market monitoring surveillance and analytic capabilities..

NO IMPACT TO GRID MANAGEMENT CHARGE

Increasing the targeted level of capital expenditures in 2012 has no impact on the current grid management charge rates being paid by market participants. The ISO collects funds to be used for capital expenditures either through the issuance of bonds or through the cash-funded component of the annual revenue requirement. The Board approves a targeted level of actual capital expenditures during the budget process which may or may not be at the same level as the capital being collected in the current year. This results in a varying amount of capital reserves that are available for situations like those outlined in this memo. For example, in 2011, the Board approved capital expenditures at a targeted level of \$23.5 million; however, Management capped actual expenditures at \$19.6 million, resulting in the addition of approximately \$4 million in capital reserves. Over the long-term, the ISO intends to manage its capital reserves account to allow for anticipated capital expenses to be funded without the need for new bond issuances or major fluctuations in the revenue requirement. This allows more predictability for those paying rates and for cost savings to the extent the ISO can avoid a new bond sale.

The FERC settlement has no impact on the capital reserves as the \$1 million was received from a third-party for this specific use.

CONCLUSION

Management recommends that the Board increase the 2012 targeted capital project budget to \$24.4 million, an increase of \$3.6 million from its current approved amount of \$20.8 million.