

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System)
Operator Corporation)
)

Docket No. ER00-_____-000

PREPARED DIRECT TESTIMONY OF
ZORA LAZIC
ON BEHALF OF THE
CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION

1 **Q. PLEASE STATE YOUR NAME, AND BUSINESS ADDRESS.**

2 A. My name is Zora Lazic. My business address is 151 Blue Ravine Road,
3 Folsom, California 95630.

4

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 A. I am employed by the California Independent System Operator
7 Corporation as Vice President of Client Services. In that capacity, I am
8 the ISO officer responsible for Client Relations and Contracts &
9 Compliance. In particular, since November 1999, I have been the
10 executive sponsor responsible for the ISO's development of a revised
11 transmission Access Charge methodology.

12

1 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
2 **QUALIFICATIONS.**

3 A. I received a Bachelor of Arts degree in Political Science, as well as a
4 Bachelor of Civil Law and a Bachelor of Law (LLB) from McGill University,
5 in Montreal. I became a member of the Bar of British Columbia in 1985
6 and in 1986 obtained a Master of Laws (LLM) at the University of
7 Cambridge, England.

8
9 Following graduation, I practiced corporate law. I joined the British
10 Columbia Hydro and Power Authority in 1989 and served in a number of
11 positions including, most recently, as Associate General Counsel at
12 Powerex, its power-marketing subsidiary. While in that position, I also
13 served as an advisory member of the ISO Board of Governors. In August
14 1999, I assumed my present position with the ISO.

15
16 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

17 A. The purpose of this testimony is to describe the objectives that the ISO
18 and the ISO Governing Board sought to achieve in developing a revised
19 transmission Access Charge methodology and how the transmission
20 Access Charge methodology proposed in Amendment No. 27 fulfills those
21 objectives.

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Q. AS YOU TESTIFY, WILL YOU BE USING ANY SPECIALIZED TERMS?

A. Yes. I will be using terms defined in the Master Definitions, Appendix A of the ISO Tariff.

Q. WHAT ROLE DID YOU PLAY IN THE ISO'S DEVELOPMENT OF A NEW TRANSMISSION ACCESS CHARGE METHODOLOGY?

A. Beginning in November 1999, I directed the ISO's participation in the process that had been established to receive the input of stakeholders in connection with the development of a new transmission Access Charge methodology by the ISO. In particular, I took part in the meetings of the negotiating group of members of the ISO Governing Board that was established in October 1999 to flesh out an Access Charge methodology that was consistent with the principles adopted by the ISO Governing Board at that meeting. I also represented the position of ISO management at stakeholder meetings and at meetings of the ISO Governing Board at which the Access Charge methodology was discussed. In these efforts, I worked closely with Deborah Le Vine, the ISO's Director of Contracts & Compliance, and provided executive direction for the ISO's efforts to develop a new Access Charge rate methodology.

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**I. THE NATURE OF THE PROPOSED
TRANSMISSION ACCESS CHARGE METHODOLOGY**

**Q. HOW WOULD YOU CHARACTERIZE THE ACCESS CHARGE RATE
METHODOLOGY THAT IS PROPOSED IN AMENDMENT NO. 27?**

A. The Access Charge rate methodology that the ISO proposes in Amendment No. 27 is designed to achieve several objectives, which I will discuss later in my testimony. It reflects a clear vision of the “end state” for the Access Charge: the establishment of a single charge for access to the high voltage transmission facilities of the ISO Controlled Grid, based on the costs of facilities owned by all Participating Transmission Owners ("Participating TOs") in the region. If transmission owners who currently do not participate decide to join, then the transmission revenue requirements of such new Participating TOs would also be included.

At the same time, the proposed Access Charge rate methodology is best understood as a compromise among the interests of the different classes of stakeholders that are affected by the manner in which the costs of the transmission facilities that make up the ISO Controlled Grid are recovered and is a delicate balance of benefits and burdens. The compromise is reflected in a number of inter-related provisions of Amendment No. 27,

1 which are discussed in detail in the testimony of Ms. Le Vine. They
2 include provisions that provide incentives for entities that own
3 transmission facilities that could be included in the ISO Controlled Grid (or
4 have contractual entitlements to use such facilities) to become
5 Participating TOs. They also include provisions that are designed to
6 prevent or limit abrupt shifts in the costs paid by customers for access to
7 the ISO Controlled Grid during the transition toward a single rate for
8 access to the grid's high voltage transmission facilities.

9
10 As with any compromise, the proposed Access Charge rate methodology
11 will necessarily appear imperfect when viewed from the standpoint of any
12 particular stakeholder or class of stakeholders. Also, the compromise
13 Access Charge rate methodology is not a perfect means of achieving any
14 single objective. For example, as I will explain, one of the ISO's principal
15 objectives was to develop an Access Charge methodology that would
16 encourage entities with transmission facilities and contractual Entitlements
17 to become Participating TOs. The ISO nevertheless recognizes that this
18 negotiated compromise Access Charge methodology cannot and does not
19 ensure that all such entities will immediately place their transmission
20 facilities and Entitlements under the ISO's Operational Control.

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1 Thus, while the proposed Access Charge methodology does not satisfy
2 fully the concerns of any stakeholder or class of stakeholders or achieve
3 fully the objectives of any class of stakeholders, the ISO believes that it
4 represents a fair and equitable means of recovering the costs of the
5 transmission facilities included in the ISO Controlled Grid. The ISO also
6 believes that it has selected appropriate objectives for an Access Charge
7 methodology and that the proposal embodied in Amendment No. 27
8 represents a reasonable compromise among those objectives.

9

10 **Q. WHAT ROLE DID THE ISO GOVERNING BOARD PLAY IN THE**
11 **DEVELOPMENT OF THE PROPOSED ACCESS CHARGE RATE**
12 **METHODOLOGY?**

13 A. The ISO Governing Board played a critical role in the development of the
14 proposed Access Charge methodology. As I will explain, the ISO
15 Governing Board was charged by California law with the responsibility of
16 developing an Access Charge rate methodology that results in “an
17 equitable balance of costs and benefits” among the affected parties. The
18 ISO Governing Board took this responsibility very seriously. As
19 Ms. Le Vine explains in detail in her testimony, the ISO Governing Board,
20 after considering input from stakeholders, considered and approved a set
21 of basic principles to guide the development of an Access Charge

1 methodology. Then, over the first three months of this year, the ISO
2 Governing Board held numerous meetings, including both public sessions
3 and executive sessions, to evolve the first compromise proposal to the
4 point that represents a high degree of consensus on the proposed Access
5 Charge methodology.

6
7 The ISO also was able to use the composition of the ISO Governing Board
8 to develop a representative negotiating group which assisted in
9 developing the package of compromises that is embodied in
10 Amendment No. 27. As also explained by Ms. Le Vine, when the ISO
11 became concerned in the Fall of 1999 that the large stakeholder group
12 was not progressing toward a consensus, the ISO put forth its own "straw"
13 proposal. During the October Governing Board meeting, the Board
14 provided guidance to ISO management on how to refine this proposal.
15 The Board also believed that the assistance of a negotiating group could
16 aid the discussions. Accordingly, the Chief Executive Officer of the ISO
17 recommended the appointment of a six-member negotiating group from
18 the ISO Governing Board. The members of that group included two
19 representatives of each of the stakeholder sectors that would be most
20 directly affected by an Access Charge methodology: the current
21 Participating TOs; the publicly owned utilities that could become

1 Participating TOs, but had elected thus far not to do so; and the End-
2 Users who ultimately pay the costs recovered through the Access
3 Charges. That group was able, working with the ISO, to develop the
4 compromise Access Charge methodology proposal that was later
5 approved by the ISO Governing Board.

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7 **II. OBJECTIVES OF THE ACCESS CHARGE METHODOLOGY**

8 **Q. WHAT OBJECTIVES DID THE ISO SEEK TO ADVANCE THROUGH**
9 **THE ACCESS CHARGE METHODOLOGY?**

10 A. The ISO developed the Access Charge rate methodology proposed in
11 Amendment No. 27 in order to advance six principal objectives. They are:
12 (1) the establishment of an Access Charge that creates an equitable
13 balance of costs and benefits among the various affected classes of
14 stakeholders; (2) the development of an Access Charge rate methodology
15 that was acceptable to the largest possible majority of the members of the
16 ISO Governing Board; (3) the establishment ultimately of a single rate for
17 access to the high voltage transmission facilities forming the backbone of
18 California's regional transmission grid; (4) the treatment of all Participating
19 TOs on the same basis; (5) the creation of incentives for additional entities
20 to include their transmission facilities and contractual Entitlements in the
21 regional grid controlled by the ISO and the removal of disincentives; and

1 (6) the strengthening of the ISO's independence by increasing the extent
2 to which the design of charges for transmission access was incorporated
3 in the ISO Tariff.

4

5 **Q, PLEASE DISCUSS THE FIRST OBJECTIVE YOU MENTIONED, THE**
6 **DEVELOPMENT OF AN ACCESS CHARGE METHODOLOGY**
7 **ACCEPTABLE TO THE ISO GOVERNING BOARD.**

8 A. Certainly. In the orders it issued prior to the start-up of the ISO, the
9 Commission recognized that the initial design of the Access Charge was
10 subject to review under the terms of the California electricity restructuring
11 legislation (A.B. 1890). Under that legislation, adopted in 1996, the ISO
12 was directed to recommend to the Commission, within two years of its
13 initial operation, a new rate methodology "determined by a decision of the
14 Independent System Operator governing board."

15

16 While the restructuring legislation provided for a number of fallback
17 mechanisms if the ISO Governing Board failed to reach a decision
18 (including alternative dispute resolution and a default rate methodology),
19 the ISO believed strongly that the Governing Board, if at all possible,
20 should rise to the challenge presented to it by the California legislature.

21 Accordingly, one of the key objectives of the ISO was to develop an

1 Access Charge methodology that was acceptable to a large number of
2 members of the ISO Governing Board. Because, as I have mentioned,
3 the members of the ISO Governing Board are elected by different classes
4 of stakeholders, this objective in turn required that the Access Charge
5 methodology represent a fair compromise among the interests of the
6 different groups of stakeholders.

7

8 **Q. PLEASE DISCUSS THE SECOND OBJECTIVE YOU MENTIONED,**
9 **ASSURING THAT THE ACCESS CHARGE METHODOLOGY RESULTS**
10 **IN AN EQUITABLE DISTRIBUTION OF COSTS AND BENEFITS.**

11 A. The California restructuring legislation that I mentioned specified that a
12 rate methodology determined by the ISO Governing Board be “based on
13 principles approved by the governing board including, but not limited to, an
14 equitable balance of costs and benefits.” The ISO interpreted this to
15 require an equitable balance of costs and benefits among the different
16 classes of stakeholders whose interests are affected by the Access
17 Charge methodology.

18

19 This objective is closely related to the first objective I mentioned,
20 developing an Access Charge methodology that could win the support of a
21 large majority of the ISO Governing Board. Plainly, in order to obtain the

1 support of Board members representing a broad range of stakeholder
2 groups, the ISO would have to present an Access Charge methodology
3 that results in an equitable allocation of the costs and benefits of the ISO
4 Controlled Grid.

5

6 **Q. PLEASE DISCUSS THE THIRD OBJECTIVE YOU MENTIONED, THE**
7 **ESTABLISHMENT OF A SINGLE CHARGE FOR ACCESS TO THE**
8 **HIGH VOLTAGE TRANSMISSION SYSTEM.**

9 A. The ISO believes that it is appropriate ultimately to assess the same rate
10 for access to the high voltage transmission facilities that form the
11 backbone of the ISO Controlled Grid, regardless of where the customer is
12 located. The ISO was established to separate control of transmission
13 facilities, including control of access to transmission facilities, from the
14 interests of the utilities that own those facilities and to foster broad and
15 open competitive markets for electricity. The high voltage backbone
16 transmission facilities play a key role in enabling Market Participants
17 throughout the region to engage in trade and in permitting consumers
18 throughout the region to reap the benefits of competitive markets. Since
19 customers and Market Participants throughout the region benefit from
20 these facilities and rely on them, the ISO believes it is appropriate that

1 ultimately their costs be recovered through a uniform Access Charge that
2 does not vary with the location of the customer or Market Participant.

3

4 **Q. PLEASE DISCUSS THE FOURTH OBJECTIVE YOU MENTIONED,**
5 **RELATING TO AFFORDING THE SAME TREATMENT TO ALL**
6 **PARTICIPATING TOS.**

7 A. The ISO believes that it must afford comparable treatment not only to
8 transmission customers that rely on the ISO Controlled Grid, but also to
9 transmission owners that place their facilities under the ISO's Operational
10 Control. If the ISO's Access Charge methodology affords special
11 treatment for some Participating TOs, without substantial reasons for
12 doing so and without limiting the extent and duration of the special
13 treatment, transmission owners will be discouraged from contributing their
14 facilities to the ISO Controlled Grid. Accordingly, while the proposed
15 Access Charge methodology does include provisions that afford benefits
16 for new Participating TOs that current Participating TOs do not enjoy,
17 fidelity to this objective led the ISO to limit the extent and duration of such
18 benefits.

19

1 **Q. PLEASE DISCUSS THE FIFTH OBJECTIVE YOU DESCRIBED,**
2 **EXPANDING PARTICIPATION IN THE ISO BY ENTITIES WITH**
3 **TRANSMISSION FACILITIES AND CONTRACTUAL RIGHTS.**

4 A. In Order No. 2000, the Commission recognized that a regional
5 transmission organization should have sufficient appropriate scope and
6 configuration to enable competitive electricity markets to function
7 efficiently on a regional basis. The Commission also affirmed the
8 importance of voluntary participation in regional transmission
9 organizations by all entities with transmission facilities that constitute a
10 part of the regional grid.

11
12 The ISO recognized that the methodology through which charges for
13 access are determined can have a significant impact on the willingness of
14 entities to include their transmission facilities and contractual rights among
15 those it controls on a regional basis. Entities that are prospective
16 Participating TOs would seek assurance that their transmission costs
17 would receive fair and appropriate recognition in the development of
18 Access Charges. In addition, if costs incurred by those entities might
19 increase as a result of a decision to relinquish control of their transmission
20 facilities and Entitlements to the ISO, they would want protection against

1 those increases. If these conditions are not satisfied for a particular entity,
2 then it would decline to participate.

3

4 **Q. IS THERE ANY REASON WHY ENCOURAGING PARTICIPATION IS**
5 **ESPECIALLY IMPORTANT IN CALIFORNIA?**

6 A. Yes. California's publicly-owned utilities were exempted from the
7 provisions of the restructuring legislation that required the state's investor-
8 owned utilities to place their transmission facilities under the ISO's
9 operational control. Publicly-owned utilities own transmission facilities that
10 constitute approximately twenty-five percent of the transfer capability
11 between the ISO Control Area and other control areas. Combining the
12 operation of those facilities with the facilities currently controlled by the
13 ISO would increase the efficiency of the regional grid, reducing
14 transmission congestion, and providing other benefits to the marketplace.

15

16 In addition, many publicly-owned utilities in California have transmission
17 rights to portions of the ISO Controlled Grid under contracts that predate
18 the ISO Operations Date. The Commission has directed the ISO to
19 continue to honor those Existing Contracts, including provisions enabling
20 the transmission customer to schedule transactions after the scheduling
21 deadlines normally applied by the ISO in its Day-Ahead and Hour-Ahead

1 Markets. As Ms. Le Vine explains in her testimony, the ISO's need to
2 reserve transmission capacity for the exercise of these within-the-hour
3 scheduling rights has given rise to a phenomenon known as "phantom
4 Congestion," which creates higher costs for Market Participants and
5 consumers. Decisions by publicly-owned utilities to convert their existing
6 transmission rights to ISO transmission service would reduce the costs
7 created by this scheduling disparity, benefiting all Market Participants and
8 relieving congestion on scarce import paths to California.

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10 **Q. PLEASE DISCUSS THE LAST OBJECTIVE YOU DESCRIBED,**
11 **INCREASING THE EXTENT TO WHICH THE DESIGN OF ACCESS**
12 **CHARGES IS DETERMINED UNDER THE ISO TARIFF.**

13 A. In approving the ISO's formation, the Commission determined that the ISO
14 was structured and governed in a manner that assured its independence
15 from Market Participants and the utilities that own the transmission
16 facilities it operates. More recently, in Order No. 2000, the Commission
17 indicated that maintaining the independence of a regional transmission
18 organization requires that the regional transmission organization, rather
19 than the owners of the transmission facilities it operates, determine the
20 design of rates charged for access to those facilities (subject, of course, to
21 review by the Commission).

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2 The current Access Charge methodology gives Participating TOs
3 substantial latitude in the design of charges for access to the ISO
4 Controlled Grid. This latitude arises from the fact that Access Charges
5 currently are collected under the Transmission Owner Tariffs filed by each
6 Participating TO. So, for example, one Participating TO (Pacific Gas and
7 Electric Company) has designed separate charges for the recovery of the
8 costs of its high voltage transmission facilities and its low voltage
9 transmission facilities. The other two Participating TOs, in contrast, have
10 designed single Access Charges for the recovery of the costs of all their
11 transmission facilities.

12

13 Consistent with the Commission's determination in Order No. 2000, the
14 ISO has endeavored in the proposed Access Charge methodology to
15 increase the extent to which the design of Access Charges is determined
16 under the ISO Tariff, rather than under the Participating TOs' individual
17 tariffs.

18

19 **Q. HOW DOES THE PROPOSED ACCESS CHARGE METHODOLOGY**
20 **ADVANCE THE OBJECTIVES YOU HAVE DISCUSSED?**

1 A. The proposed Access Charge methodology advances each of these
2 objectives through a balanced and integrated package of provisions that
3 implement the overall compromise reflected in the ISO's filing.

4
5 First, the proposed Access Charge methodology did receive the support of
6 a large majority of the ISO Governing Board, which approved the proposal
7 reflected in Amendment No. 27 by a 16-5 vote, with one abstention. A
8 copy of the Board resolution is provided as Exhibit No. __ (ISO-2). While
9 complete consensus was not possible, the proposed Access Charge
10 methodology was supported by Board members representing numerous
11 stakeholder classes.

12
13 Second, the proposed Access Charge methodology does result in an
14 equitable balance of costs and benefits, albeit a delicate balance, to the
15 various affected stakeholder classes. This balance is the product of the
16 integrated operation of the different provisions of Amendment No. 27,
17 which are described in detail by Ms. Le Vine. Basically, the proposed
18 Access Charge methodology recognizes that expanded participation in the
19 ISO by new Participating TOs has the potential to benefit all Market
20 Participants through reduced charges for the recovery of the ISO's
21 expenses, reduced Congestion costs through the elimination or reduction

1 of phantom Congestion, and potentially lower market prices for Energy
2 and Ancillary Services. In recognition of these benefits, the proposed
3 Access Charge methodology allows for increases in the Access Charges
4 paid by customers of current Participating TOs, with the amount of the
5 increases dependent upon the extent of increased participation by new
6 Participating TOs. In addition, in acknowledgement of the fact that many
7 of these benefits are difficult to quantify precisely, the potential increases
8 in transmission costs are capped at levels that are considered reasonable
9 by the members of the ISO Governing Board, including representatives of
10 the End-User sector that will pay the increased charges. Other
11 components of the proposed filing discussed by Ms. Le Vine further
12 mitigate cost shifts that could result from its implementation.

13
14 Third, the proposed rate methodology does ultimately result in a single
15 charge for access to the high voltage transmission facilities included in the
16 ISO Controlled Grid. To mitigate the changes in Access Charges that
17 would result from the adoption of a single “postage stamp” transmission
18 rate, the uniform rate is phased in over ten years. Additionally, all new
19 high voltage transmission facilities and capital additions to such facilities
20 are immediately included in the ISO Grid-wide component of the High
21 Voltage Access Charge.

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Fourth, the proposed Access Charge methodology specifies that, after the ten-year transition period is completed, all Participating TOs will receive uniform treatment with respect to the determination of Access Charges and other tariff provisions. To be sure, the proposed methodology includes provisions that treat current Participating TOs differently from new Participating TOs during the transition period. Those accommodations, however, were necessary for a circumscribed period to balance other objectives with the objective of equal treatment.

Fifth, the proposed Access Charge methodology includes a number of features as incentives for utilities, including publicly owned utilities in California, to become Participating TOs and removes certain disincentives. These features include the movement toward a uniform high voltage Access Charge, which benefits higher cost transmission owners that have not yet decided to join the ISO. In addition, the Access Charge methodology includes provisions to hold new Participating TOs harmless during a transition period against cost increases associated with the Access Charge and the GMC they might otherwise experience.

1 Finally, the new methodology would determine the Access Charges for the
2 recovery of the costs of Participating TOs' high voltage transmission
3 facilities under the ISO Tariff, rather than the individual Transmission
4 Owner's Tariffs. This step increases the ability of the ISO to exercise
5 control, subject to Commission review, over the design of Access
6 Charges.

7

8 **Q. HAVE ALL OF THE ISO'S OBJECTIVES BEEN FULFILLED**
9 **COMPLETELY?**

10 A. No. As I have explained, the proposed Access Charge methodology
11 reflects a package of compromises. In addition, some of the objectives I
12 have described were in tension with others; some objectives could not be
13 achieved completely unless other objectives were sacrificed. As a result,
14 a number of the ISO's objectives, as well as the objectives of the different
15 stakeholder classes, are fulfilled only in part. That is the essence of
16 compromise.

17

18 For example, the proposed Access Charge methodology defers the
19 adoption of a uniform Access Charge. This result reflects a compromise
20 between those stakeholders who wanted a uniform high voltage Access
21 Charge implemented immediately and others who were concerned that

1 any blending of the revenue requirements of different Participating TOs
2 would create unacceptable cost shifts.

3
4 In a similar vein, the proposed Access Charge methodology does not
5 ensure each entity that it will incur no cost increases at all as a result of a
6 decision to become a Participating TO. The proposal also incorporates
7 limitations on the pace at which a new Participating TO with relatively
8 higher transmission costs can obtain contributions toward those costs
9 from customers on the systems of other Participating TOs. The ISO
10 recognizes that these aspects of the proposal may cause some entities to
11 conclude that it is not in their interests to become Participating TOs at this
12 time. As I explained earlier, however, the ISO and the Governing Board
13 determined through the extensive stakeholder and negotiating processes
14 that it was not possible to satisfy fully the concerns of prospective new
15 Participating TOs without allowing for some trade-offs between important
16 objectives, including the principle that costs and benefits should be
17 distributed equitably and the goal of limiting the extent to which any
18 Participating TO received treatment more favorable than that of another
19 Participating TO.

20

1 Q. THANK YOU, MS. LAZIC. I HAVE NO FURTHER QUESTIONS AT THIS
2 TIME.