UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

Trans Bay Cable LLC Docket No. ER05-985-000

ORDER ACCEPTING OPERATING MEMORANDUM

(Issued July 22, 2005)

1. On May 19, 2005, Trans Bay Cable LLC (Trans Bay) filed an Operating Memorandum among Trans Bay, the City of Pittsburg, California (the City) and Pittsburg Power Company (Pittsburg Power). The Operating Memorandum sets forth the rate principles and operational responsibilities pursuant to which Trans Bay, the City and Pittsburg Power will pursue the development, financing, construction and operation of a high voltage direct current transmission line that would be used to transmit electricity from an existing substation adjacent to the City, underneath San Francisco Bay, to an existing substation within the City of San Francisco (the Project). This order accepts for filing the Operating Memorandum and the rate principles contained therein.

Background

2. On May 19, 2005, Trans Bay filed with the Commission, pursuant to section 205 of the Federal Power Act and Part 35 of the Commission's regulations, an Operating Memorandum among Trans Bay, the City, and Pittsburg Power. The Operating Memorandum sets forth the rate principles and operational responsibilities pursuant to which Trans Bay, the City and Pittsburg Power will pursue the development, financing, construction and operation of an approximately fifty-five mile, high voltage direct current transmission line that would be used to transmit approximately four hundred megawatts of electricity from an existing substation adjacent to the City, underneath San Francisco Bay, to an existing substation within the City of San Francisco. Trans Bay anticipates that the Project will be placed into service and transferred to the operational control of the California Independent System Operator Corporation (ISO or CAISO) in late 2008. The cost of the Project is presently estimated to be $300 million.

3. The rate principles in the Operating Memorandum propose that the Project receive: (1) a post tax 13.5 percent return on equity; (2) a three-year rate moratorium from the initial transmission revenue requirement filed pursuant to section 205; (3) a target 50/50 debt/equity capital structure; and (4) a 30-year depreciation period.

4. Trans Bay explains that its proposed rate treatment is modeled after that granted by the Commission to Trans-Elect Path 15, LLC (Trans-Elect) with respect to Trans-Elect's role in the financing of the Path 15 Upgrade.[1] Trans Bay contends that the Project is similar to the Path 15 Upgrade inasmuch as: (1) both projects address recognized and long-standing transmission problems in California that have created both reliability issues and increased costs to California ratepayers; (2) both companies lack captive ratepayers and will only recover the costs invested in development of the transmission expansion if and when the project successfully enters commercial operation and; (3) both bring new sources of capital to finance much needed expansions of the transmission system.

5. Trans Bay asserts that additional transmission infrastructure is needed in the San Francisco Bay Area. In support of that, Trans Bay states that the California Energy Commission released a report in November 2003 that concluded the following:[2]

> Under existing generation and load conditions, the transmission system regularly experiences congestion on major paths that prevents its optimal economic operation. Also, transmission constraints in major load centers such as San Francisco and San Diego affect both the economic and reliable operation of the system. Transmission upgrades, generation additions, and demand side management actions may provide solutions to these problems. However, the existing planning and permitting process have not provided effective and timely mechanisms for bringing forward such projects to provide California with a more robust and reliable transmission system.

6. Trans Bay also states that in 1999, the CAISO formed the San Francisco Stakeholders Study Group (Study Group) to evaluate, in Phase 1 of the study, the long-term energy supply adequacy within the City of San Francisco and to identify the

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[1] *See Western Area Power Administration*, 99 FERC ¶ 61,306, *reh'g denied*, 100 FERC ¶ 61,331 (2002*), aff'd, Public Utilities Commission of the State of California v. FERC*, 367 F.3d 925 *(*D.C. Cir. 2004*) (Trans-Elect).*

[2] Trans Bay filing at 3.

preferred alternatives to meet the city's forecasted electric needs. The Study Group submitted a report in October of 2000 to the CAISO Board of Governors which concluded that unless new generation resources were built within the City of San Francisco, new transmission facilities to increase the amount of power imported from outside the City of San Francisco would be needed by 2006 to meet customer demand. Subsequently, in 2002, the CAISO approved PG&E's 230 kV Jefferson-Martin transmission line. The line is scheduled to be in service in early 2006.

7. In 2004, the Study Group initiated Phase II of the study to determine the best mix of future transmission reinforcements, existing and new generation resources and load management programs required to serve load within the City and County of San Francisco and the San Francisco Peninsula. Currently, the Project is one of the alternatives that the Study Group is evaluating. Trans Bay states that the study is nearing completion and a draft report will be issued by the CAISO in the near future.

8. Trans Bay also states that the CAISO has expressed written support for the continued development of the Project.[3] The December 2004 Letter stated the following:

> Considering the nature of your project, it appears that it could provide a reasonable long-term alternative to solve the reliability concerns the CAISO has found in the San Francisco Peninsula Area. Key benefits worth considering are the elimination of "radial" electrical service to San Francisco through the peninsular corridor, the resultant reduction in power flow in that corridor, and the anticipated reduction in generation requirements within the City of San Francisco itself. On balance, these key benefits should result in improved reliability of service throughout the San Francisco Peninsula Area, possibly reduced costs to ratepayers as a result of more efficient dispatch of existing power resources in the Greater Bay Area, as well as positive environmental benefits to the local San Francisco communities that would accrue due to the reduced need for generation within the City of San Francisco.

9. The December 2004 Letter also indicated that the CAISO and the Study Group were evaluating various other projects and, in order for the Project to be selected as the preferred long-term alternative, certain requirements must be met. Among other things, the Project must demonstrate that it is the most feasible reliability project among all

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[3] *Id.* at Exhibit 1 to the Affidavit of Michael M. Garland, Letter from the CAISO to Trans Bay (December 2004 Letter).

options being considered by the Study Group, the economic analysis of the Project must demonstrate that it is the best choice, and the Project must be reviewed by the Study Group and have its support.

Notices and Interventions

10. Notice was issued on May 23, 2005, with comments due on or before June 9, 2005. The California Energy Commission filed a timely intervention, while the CAISO, Pacific Gas & Electric Company (PG&E) and Southern California Edison Company (SoCal Edison) filed timely interventions with comments. The California Public Utilities Commission (CPUC) filed a notice of intervention and motion for additional time to submit comments.

11. On June 16, 2005, and June 29, 2005, respectively, the Bay Area Municipal Transmission Group[4] and the City and County of San Francisco filed interventions out of time. On June 27, 2005, the CPUC filed comments. On June 13, 2005, and again on June 28, 2005, Trans Bay filed answers to the comments filed.

12. The CAISO states that it supports Trans Bay's pursuit of all steps necessary to ensure that the Project remains a viable alternative that can be fully reviewed and compared on its merits. The CAISO concludes that although the filing may be viewed as premature, it nevertheless requests that the Commission opine on the rate principles set forth in the Operating Memorandum.

13. PG&E seeks to limit the Commission's approval to just the rate principles contained in the Operating Memorandum. PG&E finds it premature, however, to accept the Operating Memorandum as a rate schedule under section 205 given the Study Group's efforts underway. PG&E recommends that the Commission should make clear that any approval of the rate principles in the Operating Memorandum is not intended to pre-determine the need for the Project, or to pre-empt the ongoing Study Group process. PG&E also seeks to further the Commission's approval of the rate principles upon: (1) ISO approval of the Project; (2) a requirement that, to be eligible for the rate principles, the Project must be placed under ISO operational control, pursuant to the ISO Tariff, and without any terms or conditions different from those in the ISO Tariff; and (3) a requirement that Trans Bay recover its costs of the Project through a Commission-approved transmission revenue requirement under the terms of the ISO Tariff and in

[4] The Bay Area Municipal Transmission Group is comprised of the Cities of Santa Clara, Palo Alto and Alameda, California.

accordance with the ISO's transmission access charge methodology that has been accepted by the Commission.

14. SoCal Edison supports PG&E's proposal to limit the Commission's approval to the rate principles within the Operating Memorandum. SoCal Edison asks that the Commission clarify that, through its filing, Trans Bay has fully committed to becoming a Participating Transmission Owner and would file a transmission revenue requirement and submit a transmission owner tariff with the Commission, and would abide by all terms and conditions of the Transmission Control Agreement and CAISO Tariff as they exist at the time it turns over its facility to the CAISO. SoCal Edison also notes that under the CAISO Tariff, a new participating transmission owner that serves no load is not entitled to firm transmission rights. SoCal Edison proposes additional language to clarify that transmission rights will be available only to the extent allowed by the CAISO Tariff and protocols.

15. The CPUC notes that there are four problematic cost-related issues raised by Trans Bay's application. First, the CPUC argues that Trans Bay's proposed 13.5 percent return on equity is exorbitant and should be no greater than the 11-12 percent return that SoCal Edison and other companies across the country earn on their transmission projects. The CPUC considers this project relatively low risk because it will be funded entirely on a cost-of-service basis by the CAISO's ratepayers, thus making the risk incurred by Trans Bay no greater than the risk incurred by utilities such as PG&E and SoCal Edison in funding their own transmission projects.

16. Second, the CPUC argues that it is unjust and unreasonable to require ratepayers to fund an assumed 50/50 structure when a project's actual capital structure is closer to 70 percent debt and 30 percent equity, as is the case with the Trans-Elect Path 15 project. CPUC argues that Trans Bay should be required to use its actual capital structure.

17. Third, with regard to the rate moratorium requested, the CPUC argues that the Commission should require Trans Bay to submit a new rate filing at least once every three years thereafter, and that none of the terms of the Commission's initial approval of rate principles for the project should carry over into any such subsequent filings. Finally, the CPUC asserts that because Trans Bay is also requesting revenue recovery, the request to obtain transmission rights – such as congestion revenue rights – is contrary to the existing ISO Tariff, which states that merchant transmission project sponsors may receive either revenue requirement recovery through a transmission owner tariff or transmission rights, but not both.

18. Trans Bay offers the following in response to the CPUC's comments. First, it asserts that the proposed 13.5 percent return on equity is required because Trans Bay

faces risks in the developing, financing and construction of the Project that are significantly greater than would be the case if the Project were to be pursued by a California utility subject to the jurisdiction of the CPUC. Trans Bay argues that it deserves compensation for assuming these higher risks because it is willing to bankroll the entire development, financing and construction effort for the Project, thus providing a significant and tangible benefit to California ratepayers.

19. Second, Trans Bay argues that it is requesting the same capital structure as Trans-Elect was granted through its participation in the Path 15 upgrade, and thus using the same capital structure for the first three years of operation is appropriate. In addition, it states that this incentive would be available for only the first three years of service, since Trans Bay has already committed to filing its actual capital structure at the end of the three year rate moratorium.

20. Third, with regard to the rate moratorium, Trans Bay argues that the CPUC does not appear to oppose it and that there is no justification for committing Trans Bay to a mandatory cost-of-service rate proceeding before this Commission every three years in perpetuity considering that Trans Bay will have its section 205 rights and others will have their section 206 rights. Finally, Trans Bay submits that the transmission system rights provision is not intended to allow Trans Bay to double recover the costs of the Project. It states that it is only intended to clarify that all transmission system rights and the revenues derived therefrom will be allocated to Trans Bay, the entity that is funding the entire cost of the Project. Moreover, Trans Bay argues that under the current CAISO pricing policy, any congestion revenues received by Trans Bay are credited directly against the transmission revenue requirement through the Transmission Revenue Balancing Account, ensuring that customers receive the benefits of the revenues.

Discussion

A. Procedural Matters

21. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.214 (2004), the notice of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. We will grant the motions to intervene out of time given the entities' interest in this proceeding, the early stage of this proceeding, and the absence of any undue prejudice or delay.

22. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2004), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Trans Bay's answers because they have provided information that assisted us in our decision-making process.

B. Rate Principles

23. We will accept Trans Bay's proposed rate principles. As discussed below, we find that the rate treatment requested by Trans Bay is appropriate, given: (1) the Project's benefits; and (2) the higher level of risk borne by Trans Bay as a start-up project.[5]

24. The CAISO and Trans Bay have provided a list of benefits that the CAISO market and San Francisco Bay area would experience if the project is selected by the CAISO for development. The Project has the potential to reduce congestion costs and the Reliability Must Run requirements in San Francisco, which currently exist due to the critical need for generation within the city. This reduced need for generation within the heavily populated City of San Francisco would in turn lead to a decrease in the levels of local pollution. The Project would also eliminate radial electrical service to San Francisco by completing a transmission loop, thus increasing system reliability.[6] Overall, we find that, based on the enhanced reliability, more efficient dispatch and possible environmental benefits, the Project will be beneficial. While these benefits are difficult to quantify, they are nevertheless real savings. We believe it is reasonable to set the proper rate principles and incorporate incentives to allow this project to move forward. Here, Trans Bay has requested a 13.5 percent return on equity and a 50/50 capital structure. We find below that such elements are warranted.

25. We find that Trans Bay, as a new and independent entity, bears a significant risk at the permitting and initial project development stage and in the start-up investment. Trans Bay identifies an extensive list of siting and permitting issues, including potential business disruption, housing value depreciation, environmental concerns and visual impacts. We disagree that Trans Bay faces risks similar to those that an established, investor-owned utility faces. We find that the CPUC ignores the development, financing and construction risk that Trans Bay, as a new and independent entity, also bears prior to commercial operation of the Project. Furthermore, we find that this risk borne by a start-up is greater than that of an ongoing, investor-owned utility. In general, ratepayers and

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[5] We note that acceptance of these rate principles assumes approval by the CAISO, which is currently evaluating alternatives on an economic and reliability basis. Should the CAISO find that the Project is not the preferred approach, we reserve the right to subsequently revisit our decision as a result of new facts presented by the CAISO's decision.

[6] Trans Bay notes that an independent consultant it has retained has concluded that the Project would provide economic benefits that exceed the costs.

shareholders of investor owned utilities share the prudent costs of projects that are later abandoned or cancelled.[7] Here, Trans Bay acknowledges that it will bear the risk of under recovery if the Project is ultimately abandoned. In addition, unlike an investor-owned utility, Trans Bay will not be accruing an Allowance for Funds Used During Construction (AFUDC) in association with the Project and it indicates that it will not seek to recover a development fee from customers. Accordingly, we find that the higher risk borne by Trans Bay requires enhanced rate treatment. We emphasize that the Commission has endorsed treatment – such as the higher return on equity and imputed capital structure requested by Trans Bay – for projects that take on a higher level of risk.[8]

26. We therefore find that a 13.5 percent return on equity is justified in light of the fact that it is a new project being undertaken by a start-up entity, the benefits stemming from the Project, and the elevated risk levels that Trans Bay will assume. The requested return on equity is also consistent with the enhanced returns on equity allowed by the Commission. In particular, the Commission allowed Trans-Elect in Path 15 a 13.5 percent return on equity, which included a 200 basis point adder.[9] Further, the Commission allowed Nevada Power Company a 200 basis point adder for transmission facilities that provided congestion relief, increased reliability, and connected new supply to serve the western markets.[10]

27. Additionally, we find that the requested 50/50 capital structure is reasonable given that Trans Bay is a start-up entity that lacks an established capital structure. We also note that Trans Bay indicates that this capitalization is required to obtain financing. We further note that the use of this 50/50 target capital structure is only for the first 36 months of operation. At the end of that period, Trans Bay will be required to file with

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[7] The Commission has granted up to 100 percent recovery of the prudent costs associated with facilities that are abandoned or cancelled. *See, e.g., Southern California Edison Company*, 112 FERC ¶ 61,014 (2005).

[8] 99 FERC ¶ 61,306 at 62,820.

[9] *Id.*

[10] *See Sierra Pacific Resources Operating Companies*, 105 FERC ¶ 61,178 (2003), *reh'g denied*, 106 FERC ¶ 61,096 (2004).

the Commission and reflect its actual capital structure. The Commission approved a similar capital structure in Path 15.[11] We conclude that that the 50/50 capital structure is thus reasonable.

28. The Commission finds that the proposed rate moratorium is acceptable and provides certainty in order to establish the Project. We granted the same treatment to Trans-Elect in Path 15,[12] and no party in this proceeding has opposed the three-year moratorium. Moreover, we reject CPUC's request that the Commission require Trans Bay to file new rates with the Commission every three years, because the Commission has required no other utility to make such rate change filings, and we find no reason to treat Trans Bay differently. However, we recognize that some settlements have included such provisions, and nothing prevents the parties from agreeing to similar provisions in this case. Accordingly, we will not impose it upon Trans Bay. Finally, Trans Bay has requested a 30-year depreciation life. We find that this is a reasonable period of time, it is consistent with the depreciation life provided to Trans-Elect, and no parties have raised objections to it.

C. <u>Operating Memorandum</u>

29. PG&E and SoCal Edison argue that it is premature for the Commission to accept the Operating Memorandum as a rate schedule under section 205 of the Federal Power Act. We are not persuaded by their arguments. Our acceptance of the Operating Memorandum and the rate principles therein is intended solely to allow Trans Bay to move forward with financing and preliminary matters, and, as we discuss below, does not constitute final Commission review of jurisdictional rates, terms and conditions associated with the Project.

30. Intervenors assert that Trans Bay must fully and finally commit to becoming a Participating Transmission Owner under the CAISO Tariff and place the Project under the operational control of the CAISO. SoCal Edison adds that Trans Bay must file a transmission revenue requirement and submit a transmission owner tariff with the Commission as well as abide by all terms and conditions of the Transmission Control Agreement and CAISO Tariff as they exist at the time Trans Bay turns over the Project to the CAISO. At this juncture it is sufficient that section 3.3 of the Operating Memorandum clearly states that operational control will be vested with the CAISO. We

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[11] 99 FERC ¶ 61,306 at 62,280.

[12] *Id.*

find that we need not address these issues here as there will be sufficient opportunity for parties to raise issues in the CAISO tariff filings that Trans Bay and any other Project participants will be required to make.

31. Intervenors are also concerned with section 5 of the Operating Memorandum that deals with Transmission System Rights, arguing that this section conflicts with the CAISO Tariff. The CPUC adds that the Commission should clarify that section 5 should not allow Trans Bay to collect revenues associated with the Transmission System Rights without offsetting these revenues against its Commission-approved revenue requirement. We again find that these issues are premature and are more appropriately addressed at the time Trans Bay is required to submit the CAISO tariff filings. In addition, we agree that at the time operational control of the Project is turned over to the CAISO, it should be subject to the same terms and conditions as other facilities under the CAISO's control.

32. In conclusion, our review of the Operating Memorandum indicates that it appears to be just and reasonable and that it has not been shown to be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Therefore, we will accept the Operating Memorandum for filing, grant waiver of the Commission's 120-day notice requirements, and allow the Operating Memorandum to become effective on the date on which the Project enters service, as requested. We note, however, that this is only a preliminary step that allows Trans Bay to move forward and is not the last opportunity for parties to raise issues and the Commission to review matters that are subject to its jurisdiction. Our acceptance of the Operating Memorandum and the rate principles therein is predicated on Trans Bay's acknowledgement that it is required to make subsequent filings with the Commission.

<u>The Commission orders:</u>

Trans Bay's Operating Memorandum is hereby accepted to be effective on the date the Project enters service.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.