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May 19, 2005

Honorable Magalie R. Salas  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E. Room 1A  
Washington, D.C. 20426

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SECRETARY  
2005 MAY 19 PM 12:44  
FEDERAL ENERGY  
REGULATORY COMMISSION

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

Dear Secretary Salas:

Trans Bay Cable LLC ("TBC") tenders for filing herewith, pursuant to Section 205 of the Federal Power Act and Part 35 of the Federal Energy Regulatory Commission's ("Commission's") implementing regulations, six copies of the Operating Memorandum dated May 16, 2005 among TBC, the City of Pittsburg, California (the "City") and Pittsburg Power Company ("Pittsburg Power"). The Operating Memorandum sets forth the rate principles and responsibilities pursuant to which TBC, 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 (the "Project"). TBC anticipates that the Project will be placed into service and the incremental capacity created thereby will be transferred to the operational control of the California Independent System Operator Corporation ("California ISO") in late 2008. Because the rate principles set forth in the Operating Memorandum are of critical importance to the development and eventual financeability of the Project, TBC respectfully requests that the Commission accept this Operating Agreement for filing and approve the rate principles set forth therein no later than July 1, 2005. TBC further requests that the Commission establish a comment period consistent with the Commission's acceptance of this filing by July 1.

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## I. BACKGROUND OF THE FILING

**The Parties:** TBC is a wholly-owned subsidiary of Trans Bay Holdings LLC, which is a wholly-owned subsidiary of Babcock & Brown Power Operating Partners LLC, which, in turn, is a wholly-owned subsidiary of Babcock & Brown LP ("Babcock & Brown"), a global investment bank with experience and investments in energy asset finance and development. Babcock & Brown and its subsidiaries have participated in the development and financing of numerous electric generation, transmission and distribution projects both domestically and internationally. For example, Babcock & Brown is the financial advisor to National Grid plc on the Basslink project, a four hundred and eighty megawatt, two hundred and ninety kilometer underwater, high voltage direct current transmission link currently under construction to link the island of Tasmania with mainland Australia. In addition, Babcock & Brown has served as financial advisor to Prime Infrastructure, a private equity fund, in its acquisition of Powerco, the second largest electric and gas distribution utility in New Zealand.

The City is a California municipal corporation located in Contra Costa County. The City has a population of approximately sixty thousand residents and is located near the confluence of the Sacramento and San Joaquin Rivers in the Sacramento River Basin. The City, Contra Costa County and the surrounding East Bay region have access to several thousand megawatts of generation either directly or through the existing East Bay region transmission system. That generation is available to serve the City of San Francisco but for the limited transmission capacity into the San Francisco peninsula.

Pittsburg Power is a joint powers authority that has been engaged in various electric utility matters on behalf of the City since 1996. Pittsburg Power has been involved in numerous contractual and service-provider relationships (including public-private partnerships) concerning the purchase, transmission and distribution of electricity. Pittsburg Power owns and operates the gas and electric distribution systems on Mare Island, Vallejo, California following its contracting for the purchase of those systems in 1996 from the U.S. Navy.

On March 29, 2005, a judgment was entered by the Superior Court of the State of California for the County of Contra Costa validating (i) the agreement among TBC, the City and Pittsburg Power establishing the business structure and rights and responsibilities of the parties during the development of the Project; (ii) the jurisdiction of the City and Pittsburg Power to carry out their obligations under the agreement, including the authority of the City to act as lead agency under the California Environmental Quality Act ("CEQA") and conduct the Environmental Review Process; (iii) the jurisdiction of the City and Pittsburg Power as a municipal utility to own and operate the Project assets and furnish electricity both within and outside of the City's territorial limits; and (iv) the City's authority to exercise extra-territorial eminent domain jurisdiction in support of the Project, if necessary.

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**The Need for New Transmission Infrastructure to Serve the City of San Francisco:**

In the wake of California's flawed electricity restructuring experience in the 1990's, the Legislature enacted legislation in 2002 requiring the California Energy Commission ("CEC") to prepare a biennial integrated energy policy report that was intended to be the foundation for the development of the State's energy policies and decisions in the future. The first such biennial report was issued to the Governor in November, 2003.<sup>1</sup> With respect to California's electricity needs, the CEC reported that issues with respect to the reliability of the transmission grid and congestion problems throughout the grid contributed to the sharp wholesale price increases and subsequent rolling blackouts during the summer of 2000 and the winter of 2000-2001. The Report concluded:

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.<sup>2</sup>

In recognition of the serious and unique energy infrastructure needs of the San Francisco peninsula, the California ISO, in April, 1999, formed the San Francisco Stakeholder Study Group (the "Study Group") to evaluate the long-term energy supply adequacy within the City of San Francisco and to identify preferred alternatives to meet the city's forecasted electric needs. The Study Group submitted a report in October, 2000 to the Board of Governors of the California ISO in which it 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 of the City would be needed by 2006 to meet customer demand.

The California ISO, in April, 2002, approved the construction by Pacific Gas and Electric Company ("PG&E") of the Jefferson-Martin 230 kilovolt alternating current transmission line as the preferred transmission alternative. PG&E subsequently filed its application for a certificate of public convenience and necessity with the California Public Utilities Commission ("CPUC") and, after a long and contentious permitting and siting process, the Jefferson-Martin transmission

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<sup>1</sup> 2003 Integrated Energy Policy Report, Docket No. 02-IEP-01, Publication #100-03-014F, adopted by the CEC on November 12, 2003)(the "IEP Report").

<sup>2</sup> IEP Report at 17.

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line was approved and is presently under construction. The line is scheduled to be in service in March, 2006.

Even with the addition of the Jefferson-Martin line, the Study Group has determined that additional infrastructure will be needed to ensure that reliable electric service within the City of San Francisco is maintained. As a result, in April, 2004, the Study Group initiated Phase 2 of the Study (the "Phase 2 Study"), with the stated objective being to determine the mix of future transmission system reinforcements, existing and new generation resources (including distributed generation and renewables) and load management programs required to serve load within the City and County of San Francisco and the surrounding San Francisco Peninsula. The Project proposed by TBC, the City and Pittsburg Power is one of the alternatives that is being considered by the Study Group. The Phase 2 Study is nearing completion and a draft Report prepared by the California ISO will be issued soon for comment by the Study Group members. It is expected that the comments from the Study Group members on the draft Report will be vetted over the next several weeks and that the Report will be finalized and submitted to the Board of Governors of the California ISO in July, 2005.

While the Phase 2 Study has been in progress, the California ISO has considered in parallel the social and environmental issues surrounding the continued operation of two older generating facilities within the City of San Francisco (PG&E's Hunters Point facility and Mirant's Potrero facility). Both facilities have been designated as "Reliability Must Run" ("RMR") facilities under agreements with the California ISO due to the critical need for generation within the city. In September, 2004, the California ISO announced its proposed strategy for dealing with these facilities with the issuance of its "Action Plan for San Francisco, Options and Risks" (the "Action Plan"). The Action Plan recommended: (1) the construction of the Jefferson-Martin transmission line and the completion of other transmission reinforcements would allow for the release of the RMR status for the Hunters Point facility and allow PG&E to retire that facility; and (2) the installation of four combustion turbines (forty-five megawatts each) proposed by the City and County of San Francisco plus the construction of other transmission reinforcements would allow for the release of the RMR status of the Potrero facility.<sup>3</sup> The California ISO noted in its Action Plan that the proposed TBC Project is an alternative to augment the long-term load serving capability within the San Francisco Peninsula and that the reliability and economic benefits of the Project were currently under consideration and being compared to other transmission system expansion projects to increase the amount of electricity that can be imported into the peninsula. The California ISO Board of Governors approved the Action Plan on November 10, 2004.

In sum, the California ISO has recognized since 1999 that investment in new generation and/or transmission infrastructure is critical to meeting the future energy needs within the City of

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<sup>3</sup> Mirant is in the process of retrofitting the Potrero facility with new emissions control equipment and has made no public announcement as to whether the facility will be retired once its RMR status is removed.

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San Francisco and the surrounding San Francisco Peninsula. Among the alternatives now under consideration is the TBC Project. It is the expectation of TBC that the analysis of the economic and reliability benefits of the Project by the Study Group is nearing completion and that the final California ISO Board of Governors' approval of the Project will be provided at the July, 2005 meeting.

**The Project:** As discussed above, the Project will involve the construction of an approximately fifty-five mile high voltage, direct current transmission line and associated facilities to establish a direct connection between PG&E's Pittsburg Substation located at a site adjacent to the City of Pittsburg, California in Contra Costa County to PG&E's Potrero Substation within the City of San Francisco. The transmission line will consist of an approximately 7,000 ton bundled cable consisting of a transmission cable, a fiber optic communications cable and a metallic return. The underwater portion of the transmission line will be laid by a ship or barge with special equipment in a single trench underneath San Francisco Bay. The remaining length of the transmission line (most likely a few hundred yards at either end of the line) will be buried underground, either through directional drilling or laid in a trench. In addition, the Project will involve the construction of two converter stations near each of the PG&E Substations to convert the alternating current received at the Pittsburg Substation to direct current and then back to alternating current at the Potrero Substation.

The engineering, design and construction services for the Project will be provided by Siemens Power Transmission & Distribution, Inc. and the cable will be manufactured and installed by Pirelli. Both companies are global leaders in the manufacture, construction and installation of electric generation and transmission systems, including high voltage, direct current transmission lines.<sup>4</sup> It is estimated that the process of laying the cable underneath San Francisco Bay can be accomplished in approximately one to two months, thereby avoiding any interference with spawning seasons or other fisheries issues.

The total cost of the Project is presently estimated to be \$300 million. Although there is contingency in the cost estimate, there are a number of costs that will be finalized over the upcoming months, including the costs of interconnecting with PG&E, site preparations, interconnection routes into the PG&E substations, installation of the submarine cables, among others. However, the current cost estimate is well within the range of precision provided for other transmission alternatives being reviewed by the Study Group (+50%/-25%).

**The Benefits of the Project:** Several aspects of the Project provide substantial benefits in addressing the energy infrastructure requirements for the City of San Francisco, including increased reliability and system security, operating cost savings and reduced community and

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<sup>4</sup> Babcock & Brown, Siemens and Pirelli were all involved in the construction and financing of the largest direct current transmission line ever built connecting Australia and Tasmania.

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environmental impacts relative to alternatives. As the California ISO noted in its December 20, 2004 letter to TBC:

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, possible reduced costs to ratepayers as a result of more efficient dispatch of existing power resources in the Greater Bay Area, as well as the 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.<sup>5</sup>

At present, *all* transmission into the City of San Francisco passes through a single PG&E substation. In contrast, the underwater and underground siting of the TBC transmission line not only will “complete the Bay Area Loop,” but will increase grid reliability and security throughout the region. In addition, the use of proven direct current technology provides further benefits. Because direct current is controllable, the Project offers “generator like” deliverability, an important feature to stabilize San Francisco’s radial load.<sup>6</sup> Finally, the siting of the TBC transmission line underwater should be significantly less contentious compared to the siting of comparable alternating current alternatives through populated communities and sensitive nature areas with attendant EMF, business and traffic disruption, environmental, visual and other concerns, the result of which is that these alternatives present a high risk of community opposition, delay and cost overruns.

**The Project Needs Study:** Since the early inception of the Project and on through its development efforts, TBC has coordinated with the California ISO to evaluate the need for the Project on both reliability and economic grounds. In February, 2004, at the invitation of the California ISO, TBC introduced the Project to the Study Group, which agreed that the Project had merit and should be evaluated as part of the Phase 2 Study. Resource availability and other priorities, however, prevented the California ISO at that time from undertaking the necessary studies.

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<sup>5</sup> Letter dated December 20, 2004 from James Detmers, Vice President, Grid Operations, California ISO to David Parquet, Vice President, TBC (attached to the Affidavit of Michael M. Garland as Exhibit 1)(the “December 20 Letter”).

<sup>6</sup> An alternating current line cannot be made “controllable” without significant additional expense.

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In response, TBC retained an independent consulting firm, Utility System Efficiencies, Inc. ("USE"), to prepare an economic and reliability study for subsequent review by the Study Group. Reliability studies included short circuit ratio tests, power flow contingency analyses and load serving capabilities. Economic benefits studies included the calculation of benefits attributable to loss reductions, improved economic dispatch and the deferral of other transmission or generation projects. USE analyzed the Project as both the current four hundred megawatt size as well as a six hundred megawatt size. USE concluded in its September 1, 2004 report that the Project, in both the 400 MW and 600 MW configurations, provided economic benefits that exceeded the costs of the Project but that the 400 MW option was the more economic choice because of its greater benefits to cost ratio. From a reliability standpoint, the USE study demonstrated that the Project caused no significant, unmitigatable power flow issues within the PG&E grid (subsequently confirmed by PG&E in a System Impact Study for the Project that is currently underway) and could provide long-term load serving capability to the San Francisco Peninsula, depending on the ultimate configuration selected, through 2030. Transmission grid security would also be increased by the new looped system as the peninsula would no longer have all transmission facilities concentrated in one radial system running through a single substation. The Study Group subsequently requested more details and, on September 20, 2004, USE issued an addendum to its report to update the economic analysis for developments on other transmission and generation projects throughout the San Francisco Peninsula. Again, the USE study concluded that the 400 MW TBC Project, in combination with other planned transmission upgrades and the installation of new peaking generation within the City of San Francisco, provided both a long-term, reliable and economic solution for serving load throughout the San Francisco Peninsula.

In part because of these results and following the approval of the Action Plan by the California ISO Board of Governors in November, 2004, the California ISO, in its December 20 Letter, encouraged TBC to continue with the development of the Project, noting that the Project was a key transmission alternative under consideration by the Study Group as part of the Phase 2 Study as part of the long-term solution to serving load in the San Francisco Bay area. As indicated above, a draft Report evaluating those transmission alternatives will be circulated shortly by the California ISO. It is expected that the draft Report will be finalized by the Stakeholder Group over the next several weeks and a recommendation will be made to the California ISO Board of Governors for their consideration in July, 2005.

**The Project Structure:** At present, TBC is the sole owner of the Project and has overall responsibility for the management of the Project throughout the development and construction phases. TBC is coordinating with the City and Pittsburg Power through a Project Consultation Committee on all aspects of the development, financing and construction of the Project. TBC has assumed the full development risks, is funding all development costs in connection with the Project, and will arrange the financing (both debt and equity) needed to construct the Project. The City, as discussed above, will act as lead agency to coordinate the environmental review of the Project in compliance with CEQA. Additionally, the City and Pittsburg Power have many

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other responsibilities, including the acquisition of a site for the converter station near the Pittsburg Substation and the operation and maintenance of the Project assets following the in-service date for the line.

The City and Pittsburg Power will have an option to acquire all of TBC's ownership interests in the Project and the Project assets for a nominal consideration to become effective on the date that the transmission line is placed into operation and turned over to the operational control of the California ISO. It is the expectation of TBC, the City and Pittsburg Power that the option will be exercised, a step necessary to ensure that TBC and its upstream owners do not become subject to regulation under the Public Utility Holding Company Act. Despite the transfer of the Project assets, TBC will continue to receive all transmission system rights ("TSRs") generated by the Project in accordance with the tariff and protocols of the California ISO. TBC intends, in accordance with a Transmission Control Agreement and a Participating Transmission Owner Tariff ("PTO Tariff"), to turn over the TSRs to the operational control of the California ISO. TBC will use the revenues generated by the TSRs and the PTO Tariff to pay the operation, maintenance and other ongoing costs of the Project, repay the construction and long-term debt incurred to finance the Project and repay the investors who have invested equity in the Project a return of and on their capital.

**The Development Schedule:** As discussed above, the California ISO Board of Governors is expected to consider whether to approve the Project on reliability and/or economic grounds in July, 2005. Additionally, TBC is requesting that the Commission approve the rate principles set forth in the Operating Memorandum on or before July 1, 2005. If both steps are successfully completed, TBC will complete the full environmental review under CEQA during the second quarter, 2006. TBC will also release Siemens and Pirelli to begin the preliminary engineering and design work for the transmission line. Certain business arrangements with respect to the Project cannot be delayed (for example, option payments to acquire the real estate needed for the Project). Therefore, if either of the California ISO approval or the Commission's acceptance of the rate principles sought herein is delayed, the costs of the Project and the attendant risks will be significantly increased. The objective will be to have all necessary permits and authorizations in place in order to close financing during the third quarter of 2006 and to have the Project ready to commence operations during the fourth quarter of 2008.

## **II. THE OPERATING MEMORANDUM**

The Operating Memorandum among TBC, the City and Pittsburg Power addresses the following issues:

Article 1 provides various definitions used throughout the Operating Memorandum.

Article 2 contains a description of the Project, subject to the final needs analysis being undertaken by the California ISO.



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Article 3 obligates the parties to the Operating Memorandum to carry out their obligations in good faith, using their best reasonable efforts. Article 3 also defines the respective responsibilities of each of the parties during the development and construction phases of the Project as well as after the in-service date of the Project, both in the case where either the City or Pittsburgh Power exercise their option to acquire all of TBC's interest in the Project and the Project assets (other than the TSRs) and in the case where neither exercises the option. Finally, Article 3 sets forth the agreement and understanding that all of the signatories to the Operating Memorandum will be entitled to recover their reasonable costs incurred in connection with the development, financing, construction, operation and maintenance of the Project.

Article 4 addresses the parties' ownership rights in the Project during the development and construction phase of the Project and provides the City and Pittsburgh Power the option to acquire all of TBC's rights and interests in the Project and the Project assets (other than the TSRs) effective as of the in-service date of the transmission line.

Article 5 provides that, irrespective of the exercise of the option set forth in Article 4, TBC shall have the sole right to and ownership of any compensation, value or benefits derived from the operation of the Project that flow from continued ownership of the TSRs.

Article 6 sets forth the rate-making principles that the parties request the Commission approve in establishing the transmission revenue requirement that will be recovered by the California ISO and remitted to TBC. These rate-making principles are discussed in Section III, below.

Article 7 contains miscellaneous provisions addressing the process for amending the Operating Memorandum, assigning the Operating Memorandum and when such assignment may be effected with or without the consent of the non-assigning party, the non-recourse nature of the obligations imposed on each party by the Operating Memorandum and the interpretation and applicable law governing the Operating Memorandum.

### III. THE RATE PRINCIPLES

The Commission has recognized that, over the past decade, investment in the nation's transmission infrastructure has not kept pace with load growth or with the increasing demands brought about by industry restructuring.<sup>7</sup> Further, the Commission has stated that it is prepared to take steps to encourage the construction of transmission facilities, particularly in the western United States.<sup>8</sup> The rate-making principles sought by TBC are modeled after those granted by

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<sup>7</sup> *Notice of Proposed Rulemaking, Proposed Pricing Policy for Efficient Operation and Expansion of the Transmission Grid*, 102 FERC ¶ 61,032 (2003).

<sup>8</sup> *See Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States*, 94 FERC ¶ 61,272, *further order on removing obstacles*, 95 FERC ¶ 61,225, *order on reh'g*, 96 FERC ¶

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the Commission to Trans-Elect Path 15, LLC ("Trans-Elect") with respect to Trans-Elect's role in financing the Path 15 upgrade. Although the factual circumstances surrounding the Path 15 upgrade differ somewhat from those presented by the instant filing, there are striking similarities: both projects are aimed at addressing recognized and long-standing transmission problems in California that have created both reliability issues and increased costs to California ratepayers; both companies lack captive ratepayers and will only recover the costs invested in the development of the transmission expansion if and when the project successfully enters commercial operation; and both bring new sources of capital to finance much-needed expansions of the transmission system. Additionally, and distinct from the Trans-Elect case, TBC has pursued the development of the Project as a solution to San Francisco's electricity infrastructure problems entirely at risk, having taken the risk of the loss of all of its development costs and expenses if the Commission were not to accept the rate principles set forth in the Operating Memorandum or the California ISO Board of Governors were not to approve the Project.<sup>9</sup> Moreover, TBC will continue to bear all remaining development costs and expenses and will be completely at risk for the recovery of those costs and expenses until the Project enters commercial operation under the operational control of the California ISO. The Commission has encouraged this entrepreneurial approach to meeting the country's transmission infrastructure needs and should do so here.

**The Return on Equity:** TBC seeks an initial post-tax return on equity of 13.5%. This was the return authorized by the Commission in the first *Removing Obstacles Order* for California transmission expansion projects placed in service prior to November 1, 2001<sup>10</sup> and is the same return allowed to Trans-Elect on its investment in the Path 15 upgrade.<sup>11</sup>

As discussed in the attached Affidavit of Michael M. Garland, a 13.5% equity return is necessary to be able to attract capital to the Project and is reasonable in light of the significant risks that the owners of TBC have and will continue to bear in pursuing the development of the Project. Moreover, the equity return is the only means by which the owners of TBC will be compensated for the successful development of the Project. Neither Babcock & Brown nor TBC

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61,155, *order on reh'g*, 97 FERC ¶ 61,024 (2001) ("*Removing Obstacles Orders*"); *Western Area Power Administration*, 99 FERC ¶ 61,306, *order denying reh'g*, 100 FERC ¶ 61,331 (2002) ("*Path 15 Order*").

<sup>9</sup> In contrast, if an electric utility subject to the jurisdiction of the CPUC were to undertake development of a new transmission line and the development effort was eventually abandoned, current CPUC policy would afford the utility the opportunity to recover a percentage of the prudently-incurred development costs from ratepayers. This Commission has adopted a similar policy in the past with respect to the costs of abandoned facility projects by jurisdictional utilities. *New England Power Co.*, 42 FERC ¶ 61,016, *order on reh'g*, 43 FERC ¶ 61,285 (1988).

<sup>10</sup> *Removing Obstacles Order*, 94 FERC ¶ 61,272 at 61,970.

<sup>11</sup> *Path 15 Order*, 100 FERC ¶ 61,331 at 62,538-39. The Path 15 upgrade entered service in December, 2004, after expiration of the applicable time period to be eligible for a two hundred basis point premium in the *Removing Obstacles Orders*. Nevertheless, the Commission approved the rate principles set forth in the Path 15 Letter Agreement on their merits, independent of the timing requirements set forth in the *Removing Obstacles Orders*.

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will seek to recover a development fee through the cost-based rates that will be established by the Commission prior to the Project entering commercial service.<sup>12</sup>

Finally, for TBC to be selected by the California ISO Board of Governors as the preferred long-term load serving solution for San Francisco, the Project's benefits, for reliability or economic reasons, must exceed the expected costs. The study prepared by USE clearly demonstrates that benefits exceed the costs for California ratepayers (calculated assuming that a 13.5% return on equity is in effect throughout a thirty-year term). Thus, the Commission can authorize TBC to recover a higher equity return as compensation for the risks undertaken in the development of the project (and will continue to be taken until the Project enters commercial operation) and still create immediate and significant cost savings for California ratepayers.

**TBC's Capital Structure:** Similar to the Path 15 Order, an assumed or target 50/50 capital structure for at least the first three years of service would allow TBC to achieve an acceptable return on its investment in the Project through leverage. As the Commission explained in the *Path 15 Orders*, one of the reasons why an assumed or target capital structure is reasonable is that there are no comparably situated entities to an independent transmission-only entity that would allow for a comparative analysis of the proposed capital structure.<sup>13</sup> Indeed, since Trans-Elect's participation in the Path 15 upgrade provides the closest comparison to TBC's role in the development and financing of this Project, the use of the same capital structure for the same initial three years of operations for the transmission expansion is appropriate and will result in just and reasonable rates.

Similar to the *Path 15 Orders*, TBC will commit to file with the Commission its actual capital structure at the end of the three year rate moratorium.<sup>14</sup>

**The Rate Moratorium:** It is important for the financing of the Project that there be at least an initial period of time during which the revenue stream required to make debt service payments and to pay a return to the equity investors is certain. A three-year moratorium was approved for the Path 15 upgrade and should be allowed for this Project as well. As discussed below, TBC will file a full cost-of-service rate filing shortly before the commencement of the three-year period so that the transmission revenue requirement to be recovered by the California ISO and remitted to TBC will reflect actual and current costs. Moreover, the cost of litigating a transmission rate case at the Commission is not insignificant and TBC would hope that it would not have to do so directly on the heels of its initial cost-of-service filing. The rate moratorium

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<sup>12</sup> In addition, TBC does not propose to recover AFUDC as compensation for the capitalized cost of financing during the development period (prior to construction financing) as was done by Trans-Elect for the Path 15 upgrade. See *Trans-Elect Path 15, LLC*, 109 FERC ¶ 61,249 (2004), *reh'g pending*. Babcock & Brown is fully funding all development costs prior to the close of construction financing and will not seek a return or interest on those costs.

<sup>13</sup> *Path 15 Orders*, 99 FERC ¶ 61,306 at 62,280; 100 FERC ¶ 61,331 at 62,539.

<sup>14</sup> 99 FERC at 62,280.

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will ensure that a second Commission proceeding to examine TBC's transmission revenue requirement will not be necessary for a three-year period and should be adopted.

**Depreciation:** TBC does not seek accelerated depreciation for the capital costs of the Project as a rate incentive but does request that there be a final determination on the period of depreciation so that the financing can be structured accordingly. As a result, the Operating Memorandum calls for the capital costs of the Project to be depreciated over a period of thirty years.

**Future Rate Filing:** The instant filing is a limited Section 205 filing and does not seek to put into effect specific rates or charges to be collected from customers. Instead, the filing seeks Commission acceptance of the Operating Memorandum and the Commission's approval of the rate principles contained therein. The rate principles will be applied to the actual costs incurred by TBC in the development, financing, construction, operation and maintenance of the Project. It would be premature to make a full cost-of-service Section 205 rate filing until TBC is well advanced in the development and construction process. Instead, TBC commits to make such a filing no later than ninety days before the projected in-service date of the transmission line.

#### IV. REQUEST FOR WAIVER

In connection with this filing, TBC respectfully requests waiver of Section 35.3 of the Commission's regulations so that the Operating Memorandum is allowed to become effective on the date on which the Project enters service. Further, since the Operating Memorandum addresses only rate principles, TBC requests waiver of Section 35.12 with respect to the filing of cost of service information. As discussed above, TBC commits to filing no later than ninety days prior to the projected in service date for the Project to make a full Section 205 filing providing the cost of service data that, in combination with the rate principles set forth in the Operating Memorandum, will be used to calculate TBC's transmission revenue requirement. Finally, TBC requests waiver of any other of the Commission's regulations as the Commission deems necessary in connection with the Commission's acceptance of the Operating Memorandum for filing and approval of the rate principles contained therein.

#### V. SERVICE

Copies of this filing have been served on the California Public Utilities Commission, the California Energy Commission, Pacific Gas and Electric Company and the California Independent System Operator Corporation.

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**VI. COMMUNICATIONS AND CORRESPONDENCE**

Communications and correspondence with respect to this filing should be directed to:

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**VII. ENCLOSURES**

This filing includes the following materials:

1. Exhibit A – The Operating Memorandum
2. Exhibit B – Affidavit of Michael M. Garland
3. Exhibit C – Notice of Filing suitable for publication in the Federal Register
4. Exhibit D – Certificate of Service

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Robert L. Daileader, Jr.", written in a cursive style.

Robert L. Daileader, Jr.  
Counsel to Trans Bay Cable LLC

Enclosures

cc: Ms. Jamie Simler  
Director, Western Division  
Office of Markets, Rates and Tariffs (via hand-delivery)

## **EXHIBIT A**

## Operating Memorandum

This OPERATING MEMORANDUM (the "Operating Memorandum") is entered into as of this 16th day of May, 2005 by the CITY OF PITTSBURG, a California municipal corporation (the "City"); PITTSBURG POWER COMPANY, a joint powers authority ("Pittsburg Power"); and TRANS BAY CABLE LLC, a Delaware limited liability company (the "Company").

### Recitals

**WHEREAS**, as determined by the CEC, the transmission system in California regularly experiences congestion on major paths that prevent its optimal economic operation. Transmission constraints in major load centers such as the City of San Francisco affect both the economic and reliable operation of the bulk power transmission system. The CEC has called for modernizing and upgrading the bulk power transmission system as a centerpiece of the State of California's electricity planning process. (*2003 Integrated Energy Policy Report*, Docket No. 02-IEP-01, Publication #100-03-019F, adopted by the CEC on November 12, 2003);

**WHEREAS**, the CEC has determined that transmission capacity to the City of San Francisco is limited and that the City of San Francisco is at risk of a power shortage. (*2003 Integrated Energy Policy Subsidiary Volume: Electricity and Natural Gas Assessment Report*, Docket No. 02-IEP-01, Publication #100-03-014F, adopted by the CEC on November 12, 2003);

**WHEREAS**, the California ISO has determined that the current transmission infrastructure in the San Francisco Peninsula is insufficient and has called for the timely installation of new generation and/or transmission facilities. (*San Francisco Peninsula Long-Term Transmission Planning Study Phase 2 Study Plan*, Revised Version 3.0, April 1, 2004, California ISO Stakeholder Project Joint Study);

**WHEREAS**, the Company wishes to develop the Project, a high voltage, direct current transmission line from the PG&E Pittsburg Substation, located at a site adjacent to the City within Contra Costa County, to an interconnection with the PG&E Potrero Substation within the City of San Francisco, in cooperation with the City and Pittsburg Power;

**WHEREAS**, on August 2, 2004, the City Council and the Pittsburg Power Board determined that it was in the best interests of the City and Pittsburg Power and in support of the health, safety and general welfare of the citizens of the City to support the development of the Project and approved the execution of the Project Development Agreement with the Company to establish the responsibilities and obligations of the Parties during the development of the Project;



**WHEREAS**, this Operating Memorandum is not intended to modify or alter the rights and responsibilities of the Parties as set forth in the Project Development Agreement as those rights and responsibilities will continue following the acquisition of the Project by the City and/or Pittsburg Power; and

**WHEREAS**, on May 16, 2005, the City Council of the City and the Pittsburg Power Board approved this Operating Memorandum.

**NOW, THEREFORE**, the Parties hereto enter into this Operating Memorandum to further advance the Project and fulfill their contractual obligations, and therefore agree as follows:

**1. Definitions**

- 1.1 "Affiliate"** of a specified person or entity means any other person or entity that directly, or indirectly through one or more intermediaries, controls, is controlled by or is under common control with the person or entity specified. For purposes of the foregoing, "control," "controlled by" and "under common control with," with respect to any person or entity, shall mean the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of such person or entity, whether through the ownership of voting securities, partnership or member interests, by contract or otherwise.
- 1.2 "Best Reasonable Efforts"** means reasonably prompt, substantial and persistent efforts in a manner that is commercially, technically, legally and financially reasonable in order to achieve the intent and purposes of this Operating Memorandum, but that does not require extraordinary or unusual actions that would not be reasonable under the circumstances.
- 1.3 "California ISO" or "ISO"** shall mean the California Independent System Operator Corporation, a State-chartered, non-profit corporation responsible for controlling the transmission facilities of all participating transmission owners in California or its successor.
- 1.4 "CEC"** shall mean the California Energy Commission or its successor.
- 1.5 "City"** shall mean the City of Pittsburg, a general law city and California municipal corporation.
- 1.6 "City Council"** means the duly elected and constituted governing council of the City.
- 1.7 "Company"** shall mean Trans Bay Cable LLC, a Delaware limited liability company.
- 1.8 "DC"** means direct current, an electrical current where electrical charge flows continuously in one direction.
- 1.9 "Effective Date"** shall mean the date on which this Operating Memorandum is executed by both Parties.
- 1.10 "EPC Contract"** means a contract for the engineering, procurement and construction of a portion of the Project.

- 1.11 **"FERC"** shall mean the Federal Energy Regulatory Commission or its successor.
- 1.12 **"In Service Date"** shall mean the date on which the Transmission Line is placed in service under the operational control of the California ISO.
- 1.13 **"Party" or "Parties"** means the Company, the City, Pittsburg Power and their respective permitted successors and assigns.
- 1.14 **"PG&E"** shall mean Pacific Gas and Electric Company.
- 1.15 **"Pittsburg Power"** means the Pittsburg Power Company, a joint powers authority formed by the City and the Redevelopment Agency of the City of Pittsburg.
- 1.16 **"Project"** shall have the meaning set forth in Section 2.1.
- 1.17 **"Project Assets"** means all tangible and intangible property necessary for the construction and operation of the Project, including, without limitation, land and land rights, easements, construction materials, permits, certificates, governmental approvals or authorizations, design and construction plans and documents, fully or partially constructed portions of the Project and all EPC Contracts or other contracts being used for the construction, operation, maintenance, management or any other purpose related to the Project, exclusive of Transmission System Rights.
- 1.18 **"Project Development Agreement"** means the Project Development Agreement dated August 2, 2004 by and between the Company, the City and Pittsburg Power delineating the roles and responsibilities of the Parties with respect to the development of the Project.
- 1.19 **"Transmission Line"** shall mean the DC transmission line to be constructed between the Pittsburg converter station within the City of Pittsburg, California and the converter station within the City of San Francisco with an expected rating of between four hundred megawatts (400 MW) and six hundred megawatts (600 MW) in incremental transmission transfer capability in an East-to-West direction, as determined by the Western System Coordinating Council.
- 1.20 **"Transmission System Rights" or "TSRs"** shall mean any and all rights to use, receive value for, or derive benefit from the transmission capacity created by the Project. TSRs include, without limitation, all associated, appurtenant and necessary rights thereto, including "firm transmission rights" and "financial rights," (and the revenues derived therefrom), as defined in the California ISO Tariff and Protocols and any alternative or successor rights or entitlements, and further include any property or economic rights or authorizations necessary to realize the full economic benefit of such TSRs. The use of this definition shall not limit the Company in seeking any additional or alternative revenues or rights that are authorized by the FERC due to the beneficial increase in the California ISO-controlled grid capacity resulting from the Project.

## **2. Description of Project**

- 2.1 The Project:** The Project shall include the design, permitting, financing, construction, commencement of operation and maintenance of the Transmission Line and associated facilities to transmit electricity through a dedicated connection between PG&E's Pittsburg Substation adjacent to the City of Pittsburg, California, to the PG&E Potrero Substation within the City of San Francisco, California. The Parties currently contemplate that the Transmission Line will provide incremental transmission transfer capability of between four hundred megawatts (400 MW) and six hundred megawatts (600 MW) with the final transmission transfer capability determined as a result of the needs analysis undertaken by the California ISO.

## **3. Project Management and Operations**

- 3.1 Cooperation of the Parties:** Each Party agrees to cooperate in good faith with the other Party and use its Best Reasonable Efforts to carry out its obligations hereunder. Each Party agrees to use commercially reasonable efforts to (i) cooperate with the other Party in all material respects in identifying and resolving all issues in connection with the implementation of this Operating Memorandum and (ii) otherwise taking all reasonable steps and perform all reasonable actions necessary to accomplish the purposes and intent of this Operating Memorandum. Each Party shall designate representatives to participate in a Project Consultation Committee, which is established to facilitate regular communications and coordination on all developments with respect to such matters as the development, financing and construction of the Project.
- 3.2 Project Management Responsibilities:** From the Effective Date until the In Service Date, the Company shall have overall responsibility and authority for the management of the Project, with the right and responsibility to make all decisions with respect to the development, financing and construction of the Project, including, but not limited to, design and engineering studies, siting, permitting and application for all governmental approvals, contract negotiation and administration, materials and equipment acquisition, environmental compliance, land acquisition, construction management, and debt and equity financing of the Project. Commencing on the date on which the Transmission Line is placed in service, the City, Pittsburg Power or City's designee shall have overall responsibility for the operation and maintenance of the Transmission Line and for the on-going management of the Project; provided, however, that if the City or Pittsburg Power have not exercised the option to acquire the Project Assets pursuant to Section 4.2 of this Operating Memorandum, the Company shall retain such overall responsibility. The respective roles and responsibilities of the Parties with respect to the development of the Project are set forth in the Project Development Agreement.

- 3.3 Project Operations:** Following the In Service Date, the Project will be operated in coordination with the existing transmission system and in accordance with prudent utility practice as a transmission facility within the California ISO's control area. Scheduling of electricity deliveries shall be performed in accordance with the appropriate control area scheduling procedures and standards consistent with the North American Electric Reliability Council and/or the business practices and procedures adopted in the standard market design adopted by a FERC-certified Regional Transmission Organization operating in California. Operational control of the Transmission Line will be vested in the California ISO.
- 3.4 Recovery of Project Costs:** It is the intention of the Parties that all reasonable costs incurred by each Party in connection with the development, financing, construction, operation, maintenance and repair of the Project, including but not limited to fees paid to counsel, consultants, financial advisors, among others, will be recovered through the transmission revenue requirement and transmission rates established by the FERC pursuant to Section 6 of this Operating Memorandum. The Company shall be responsible for making payment to the City/Pittsburg Power for such reasonable operations, maintenance and repair costs incurred or to be incurred by the City/Pittsburg Power with respect to the Project.

**4. Ownership Rights in the Transmission Line**

- 4.1 Initial Ownership Structure:** From the Effective Date until the In Service Date, the Company shall be the sole and exclusive owner of the Project and, consistent with Section 3.2, shall have the sole right and responsibility to make all decisions regarding the development, financing and construction of the Project.
- 4.2 City/Pittsburg Power Option:** Effective as of the In Service Date of the Transmission Line and subject to the receipt of all necessary regulatory approvals, either the City or Pittsburg Power shall have the right to purchase from the Company, in accordance with the terms and conditions to be agreed upon by those Parties, the Company's ownership interest in the Project Assets, including the Transmission Line, any real estate interest acquired by the Company in connection with the development of the Project and the Company's interest in any other Project Assets. In the event that either the City or Pittsburg Power exercises its option to acquire the Company's ownership interest in the Project Assets, it is nevertheless the intention and expectation of the Parties that the Company will continue to receive all Transmission System Rights created by the Project.

## 5. Transmission System Rights

- 5.1 **Ownership and Allocation of Transmission System Rights:** The Company shall have the sole right to the ownership and allocation of the Transmission System Rights created by the Project and all financial benefits derived therefrom. The Company intends to utilize such TSRs (and revenues derived from the California ISO associated therewith) in order to obtain financing of the Project. The Company's right to own and allocate such TSRs shall continue for ninety-nine (99) years from the In Service Date.

## 6. FERC Rate-Making Principles

- 6.1 **FERC Jurisdiction:** The rates, terms and conditions established by the Company with respect to the wholesale transmission service provided over the Transmission Line shall be established by the FERC. The transmission revenue requirement and the transmission rates will be just and reasonable. The Parties are in support of the rate-making principles set forth below applicable to the establishment of the Company's transmission revenue requirement and seek FERC approval of those rate-making principles in the context of the FERC's acceptance for filing of this Operating Memorandum under Section 205 of the Federal Power Act.
- 6.2 **Rate Principles:** The Company's transmission revenue requirement shall be calculated based on the following rate-making principles:
- a. **Return on Equity:** A post-tax return on equity of 13.5%;
  - b. **Assumed Capital Structure:** An assumed capital structure of fifty percent equity and fifty percent debt;
  - c. **Rate Moratorium:** A moratorium on any changes to the Company's transmission revenue requirement or the wholesale transmission rates charged for service over the Transmission Line for a period of thirty-six months following the month in which the In Service Date occurs. During such thirty-six month period, the standard of review for changes to the Company's transmission revenue requirement calculated in conformance with the rate-making principles set forth in this Operating Memorandum proposed by a party, a non-party or the FERC acting *sua sponte* shall be the "public interest" standard of review set forth in *United Gas Pipeline Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956)(the "Mobile-Sierra" doctrine. Following the expiration of such thirty-six month period, a change in the Company's transmission revenue requirement proposed by a Party, a non-party or the FERC acting *sua sponte* shall be reviewed under the "just and reasonable" standard under Sections 205 or 206 of the Federal Power Act, as applicable.

- 6.3 **Depreciation:** The capital costs of the Project shall be depreciated over a period of no less than thirty years.
- 6.4 **Recovery of Revenue Requirement:** The Company shall recover its transmission revenue requirement from the California ISO. The Company shall file with the FERC under Section 205 of the Federal Power Act its transmission revenue requirement in connection with the development, construction and operation of the Project calculated in conformance with the rate-making principles set forth in this Operating Memorandum no later than ninety days before the projected In Service Date.

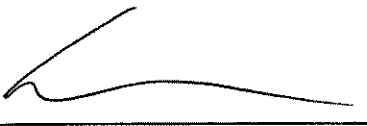
7. **Miscellaneous Provisions**

- 7.1 **Amendments:** This Operating Memorandum may be amended only by the mutual agreement of the Parties. No amendment of this Operating Memorandum shall be binding unless it is in writing, executed by both Parties and filed with and accepted for filing by the FERC.
- 7.2 **Assignment:** No Party shall assign this Operating Memorandum or its rights thereunder without the prior written consent of the other Parties, which consent shall not be unreasonably withheld. Upon any assignment made pursuant to this Section 7.2, this Operating Memorandum shall inure to and be binding upon the successors or assigns of the assigning Party. Notwithstanding the foregoing, the Company, without the need for the consent from the other Parties, may (a) transfer, pledge or assign this Operating Memorandum as security for any financing with financing institutions, and (b) as otherwise provided for in the Project Development Agreement.
- 7.3 **Non-Recourse Obligations:** The obligations of each Party hereunder shall be without recourse to any of the directions, officers, shareholders, partners, members, employees, agents, board members, Council members or Affiliates of such Party or of any of the foregoing.
- 7.4 **Interpretation and Governing Law:** The language in all parts of this Operating Memorandum shall, in all cases, be construed as a whole and in accordance with its fair meaning. The Parties agree that the laws of the State of California shall govern the construction and implementation of this Operating Memorandum. This Operating Memorandum shall be deemed to have been entered into, and obligations hereunder to have been incurred and performed, in San Francisco, California. Each Party stipulates to venue in the City and County of San Francisco.

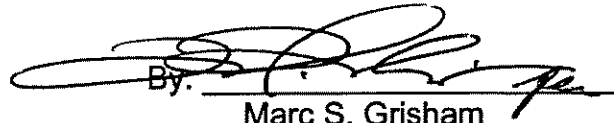
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**WHEREFORE**, the Parties have executed this Operating Memorandum below, further agreeing that execution may be in multiple counterparts, each executed copy of which shall constitute an original of the same instrument.

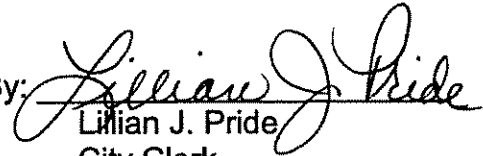
TRANS BAY CABLE LLC

By:   
David J. Parquet  
Vice President

CITY OF PITTSBURG

By:   
Marc S. Grisham  
City Manager

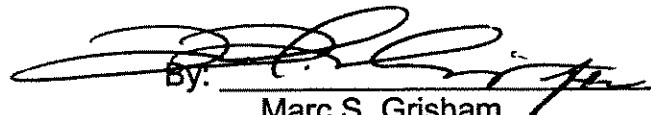
Attest:

By:   
Lillian J. Pride  
City Clerk

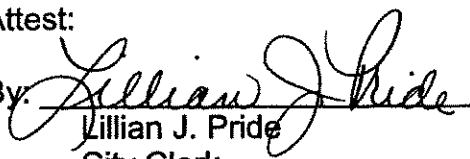
Approved as to form:

  
Ruthann Ziegler  
City Attorney

PITTSBURG POWER COMPANY  
JOINT POWERS AUTHORITY

By:   
Marc S. Grisham  
Executive Director

Attest:

By:   
Lillian J. Pride  
City Clerk

**EXHIBIT B**



**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

**Trans Bay Cable LLC**

**Docket ER05- -000**

**AFFIDAVIT OF MICHAEL M. GARLAND  
ON BEHALF OF  
TRANS BAY CABLE LLC**

State of California                    )  
  )     SS:  
County of San Francisco            )

Michael M. Garland, being duly sworn, deposes and says:

**I. BACKGROUND**

1. My name is Michael M. Garland. I am head of the U.S. Infrastructure & Project Finance Group at Babcock & Brown LP ("Babcock & Brown"), a global investment and advisory firm which specializes in structured finance and the creation, syndication, ownership and management of asset-based investments, including electric transmission assets. Babcock & Brown has twenty-one offices around the world and over \$9 billion of assets under management. My business address is 2 Harrison Street, 6<sup>th</sup> Floor, San Francisco, California 94104.

2. My professional background is as follows: I have worked at Babcock & Brown since 1986. I was hired to start Babcock & Brown's project finance business which has been successfully expanded worldwide. Since 1986, I have led the financing of power projects in Asia and Europe; however, my primary focus and responsibility has been the development, construction and financing of electric infrastructure investments in this country. Since the 1990's, Babcock & Brown has been recognized as one of the leaders of structured financings in the power sector.

3. Prior to joining Babcock & Brown, I was Director of the Office of Energy Assessments for the Department of General Services for the State of California. In that capacity, I was responsible for the State's energy policies and practices, including, for example, procurement and design practices.

4. Prior to joining the Department of General Services, I had my own consulting company.

5. During my 19 years at Babcock & Brown, I have participated in over \$20 billion of energy and energy-related project and company financings, both in the unregulated and the regulated utility sectors. I have experience acting as financial advisor to regulated and unregulated utility companies which were buying, selling and/or refinancing power assets as well as for developers, lenders, investors, owners and/or operators of power assets. These transactions used various financing structures, including, for example, construction debt, bank and bond senior debt, mezzanine or sub-debt, bridge financing, capital and operating leases, preferred equity, passive and active equity.

6. I hold a B.A. degree in Physics from the University of California, Berkeley.

## **II. SUMMARY OF AFFIDAVIT**

7. The purpose of my Affidavit is to explain and justify the reasonableness of a 13.5% post-tax return on equity sought by Trans Bay Cable LLC ("TBC") for the Project (the "Project") and why such a return is necessary to attract capital to the Project. The Project is more fully described in the Transmittal Letter accompanying the filing with the Federal Energy Regulatory Commission (the "Commission") of the Operating Memorandum between TBC, the City of Pittsburg and Pittsburg Power Company.

## **III. AFFIDAVIT**

8. As background, I would like to briefly describe why I think this Project is an important part of the solution in addressing the inadequate electricity infrastructure currently used to serve load in the City of San Francisco and the San Francisco Peninsula. There are currently two large power plants operating within the city limits. These plants are old and considered by many to have high air emissions and to contribute to local health problems (although I understand that the owner of one of the plants is in the process of retrofitting its plant with new emissions control equipment). For many years, the local communities around these plants have requested, and politicians have promised, to have these plants shut down. Additionally, in recent years, the California Independent System Operator Corporation (the "California ISO") and Pacific Gas and Electric Company ("PG&E") have attempted to balance these community concerns, in the face of the need for new transmission capacity into San Francisco and a preference for at least some in-city power generation. After enormous efforts by the California ISO, PG&E, the City of San Francisco and other organizations and community groups, two projects were proposed to provide an interim solution (both of which we support): (1) the construction by PG&E of the Jefferson-Martin transmission line (the "Jefferson-Martin Line"), a twenty-six mile, 230 KV alternating current ("AC") high voltage transmission line running between PG&E's Jefferson substation in Redwood City and the Martin substation near the San Francisco Airport and (2) the City and County of San Francisco's ("CCSF") proposed small combustion turbine project ("CCSF CT Project"), involving

the construction of four 45 MW gas-fired combustion turbines within the city limits. The Jefferson-Martin Line has been permitted and sited and is under construction after considerable community opposition and cost increases. The CCSF CT Project is in the permitting phase and has experienced delays, although I believe that CCSF will ultimately be successful in its efforts. However, the Jefferson-Martin Line and the CCSF CT Project together are insufficient by themselves to serve the expanding load within the City of San Francisco and on the Peninsula.

9. The permitting and siting process experience by PG&E with the Jefferson-Martin Line is a good example of how difficult it is to build new transmission to serve the load in San Francisco. Issues of EMF, business disruption, housing value depreciation, environmental issues, visual impacts, among others, have made the process of siting and permitting such a large, high voltage AC transmission line along the heavily-populated Peninsula corridor extremely contentious, expensive and lengthy. As a result of community opposition to the original design of the Jefferson-Martin line, much of the line ultimately had to be changed from an overhead line to an underground line at considerable cost and delay.

10. During the approval process of the Jefferson-Martin Line, and more recently during the latest meetings of the San Francisco Stakeholder Study Group, several alternative solutions to address the City of San Francisco's long-term electric infrastructure needs were proposed and considered. Other AC alternatives were considered, including a cross-Bay alternative to the East Bay Sobrante or Moraga substations. During the Jefferson-Martin line approval process, that cross-Bay alternative was rejected for various reasons. With respect to the TBC Project, as stated in the December 20, 2004 letter (attached to this Affidavit as Exhibit 1), the California ISO has encouraged TBC to continue with the development effort while it and the San Francisco Stakeholder Study Group analyzes the various alternatives.

11. The need for a long-term load serving solution for the City of San Francisco has been clear for several years. Also clear, however, is that the usual choices – generation and transmission – are very difficult to implement. We noted that the generator-like capabilities of the high voltage direct current ("HVDC") Cross Sound Cable Project's transmission line, constructed beneath the Long Island Sound to the island, provided a unique solution to a very similar problem (similar to San Francisco, Long Island is a large, important load situated at the end of a radial transmission system and, like San Francisco, it is heavily populated, making it difficult to construct generation or transmission projects.) We also noted that this Commission was supportive of independent transmission projects and, specifically, good progress was being made on the Path 15 Project in central California. The progress being made on the Path 15 expansion was particularly important because a private party (Trans-Elect) was participating in the development of the project by arranging the financing, in part because of the encouragement of the Commission's Removing Obstacles Orders. The Commission's June 12, 2002 Order Accepting Letter Agreement (the "June 12 Order") in Docket No. ER02-1672-000 accepting the Path 15 Letter Agreement demonstrated to us that entities other than electric utilities have a role to play in the development of new transmission

infrastructure in California. The June 12 Order also acknowledged that rate principles different from those typically applied to a traditional regulated utility cost-of-service rate proposal were appropriate given the unique nature of the transmission project and the significant benefits to customers attributable to the project. In the case of the Path 15 Project, the Commission approved for Trans-Elect a 13.5% return on equity, a target 50% equity/50% debt capital structure and a three-year rate moratorium. Although not involved in Path 15, we evaluated the rate principles accepted by the Commission in its June 12 Order and believe they are reasonable and necessary to attract capital to such a project.

12. In 2002, we conceptualized plans for a HVDC transmission line linking the City of San Francisco with the generation-rich East Bay region to the east. Based on our preliminary evaluation, we believed that such a project could be a viable alternative to the various projects proposed by others to solve San Francisco's electric infrastructure needs. Beginning in late 2003, we began to expend considerable time, effort and funds on the development of the TBC Project, with no ability to recover any of these resources unless the project was successfully developed, financed, constructed and placed into service. Our efforts have included everything required for a sound technical, business, political and regulatory solution for San Francisco's long-term electric infrastructure problem. Among many other tasks, we undertook the following: We analyzed the current transmission grid configuration in the region and developed multiple alternative transmission plans. We undertook technical (including construction and equipment), social (community disruption), regulatory and environmental evaluations of these alternatives. After considerable time and effort, we concluded that the concept of a HVDC line from the City of Pittsburg to the City of San Francisco was the best and most cost-effective alternative. We convinced the California ISO that such a HVDC line had merit, and we are now included in the evaluations of the San Francisco Stakeholder Study Group in its Phase 2 Study. We structured agreements with the City of Pittsburg to develop a business and permitting solution. We expended significant effort in due diligence regarding alternate routes for the HVDC line, and ultimately settled on the Bay route. We selected the firms of Siemens and Pirelli as our technology suppliers and constructors of the Project. We initiated the permitting and siting process under the California Environmental Quality Act, a significant effort in California, given the numerous stakeholders and issues that must be addressed. We assembled a first class team of experts to assist us in developing the Project, including community relations firms to assist us in addressing the numerous issues of the citizens in San Francisco. Today, we have nearly 50 experts working on various aspects of the TBC Project. We are convinced, based on our studies and efforts to date, that the TBC Project is the best solution for San Francisco's long-term electric infrastructure needs.

13. In particular, I believe that the TBC request for an initial 13.5% post-tax return on equity for the first three years following the in-service date for the Project is reasonable and will result in just and reasonable rates to California electric customers. As discussed above, Babcock & Brown has already devoted significant resources in developing the Project over the past year to get to this point, with no assurance that the Project can be successfully completed. Even if the Commission were to accept the

Operating Memorandum between TBC, the City of Pittsburg and Pittsburg Power, Babcock & Brown and TBC must still (a) obtain the approval of the California ISO through the Stakeholder Study Group process (a process which will determine whether the Project should proceed on reliability and/or economic grounds); (b) complete the environmental review process under the California Environmental Quality Act; (c) negotiate and execute numerous commercial contracts; (d) obtain construction and long-term financing; and (e) be successfully constructed, tested and operational control turned over to the California ISO. If we fail at any point along the way, the significant resources devoted to the Project will be written off and ratepayers will not be asked to contribute a single dollar to the costs incurred. In contrast, I understand that if this kind of project were being developed by a traditional regulated electric utility, both this Commission and the California Public Utilities Commission have in the past allowed utilities to recover from customers a significant percentage (*i.e.*, in excess of 50%) of the prudently-incurred costs of abandoned or cancelled projects. In our situation, customers will only bear these costs if and when the Project enters service. Moreover, TBC will not be accruing AFUDC during the development phase of the Project and will not seek to recover a development fee from customers. Thus, the return on equity is the only mechanism to compensate TBC and its equity investors for the risks they are undertaking in the development of the Project and for the benefits that customers will realize if the Project enters service. Finally, I would note that the San Francisco Stakeholder Study Group is in the process of completing a needs analysis to determine whether the reliability and/or economic benefits to customers from the reduction in line losses, improvements in economic dispatch, improved security, improved load service capability and the deferral of other generation or transmission expansion projects exceed the estimated costs of the Project. I am confident that the needs analysis will show significant benefits in excess of the Project costs, even with the requested rate principles included in the cost estimates. Of course, the Stakeholder Group and the California ISO must ultimately confirm that that is the case for the Project to go forward but, if it does, the completion of the needs analysis and approval by the Stakeholder Group and the California ISO will be a clear demonstration that the Project will benefit California and its electric customers. In light of these considerations, I believe that a return on equity at least equal to that granted to Trans-Elect for the Path 15 expansion project is reasonable.

14. Additional to our reasoning above, I have over the past months tested the financial markets to assess the conditions under which the TBC Project could be financed and the attendant returns that would be expected. I have found that financial structures that we can associate with the 13.5% post tax equity return are suitable to financing the Project. Conversely, I do not believe that the Project would be financeable at traditional utility rates of return in light of the significant development risks being undertaken. In other non-regulated energy project financings of which I am aware, the developer typically expects to recover a significant development fee when it has successfully reached construction financing. In the present case, we are not seeking to recover a development fee nor are we seeking to recover capitalized interest prior to construction financing. As Babcock & Brown will be investing its own or its affiliates' capital in the completed financial structure of the Project, we believe that the same return as provided to Trans-Elect for the Path 15 expansion project will provide a sufficient return on long

term capital and compensate us for the risk of our development and construction capital investment.

15. In summary, I believe that:

- a) There is a demonstrated public need for a substantive, long-term solution to San Francisco's electric infrastructure needs;
- b) Babcock & Brown has developed a unique solution to those needs in the TBC Project that had not been proposed previously;
- c) Babcock & Brown has undertaken at considerable cost, time, resources and reputation the development of the TBC Project to the point that it could be seriously considered and evaluated for approval with no opportunity to recover its costs unless and until the Project enters commercial operation; and
- d) The requested 13.5% post-tax return on equity is consistent with the Commission's June 12 Order for the Path 15 expansion project and with the market requirements for a project undertaking such as the TBC Project.

16. That concludes my Affidavit as to reasonableness of a 13.5% post-tax return on equity for the Project and why such a return is necessary to attract capital to the Project.

**EXHIBIT 1 TO AFFIDAVIT OF  
MICHAEL M. GARLAND**



Jim Detmers  
Vice President, Grid Operations

December 20, 2004

Mr. David Parquet  
Vice President  
Trans Bay Cable LLC  
c/o Babcock & Brown Power  
Operating Partners  
2 Harrison Street, 6<sup>th</sup> Floor  
San Francisco, CA 94105

Dear Mr. Parquet:

The purpose of this letter is to express the California Independent System Operator's (CAISO) continued support for Babcock & Brown's efforts towards the development of the Trans Bay DC Cable Project (Project). Based upon your Need study as amended on September 20, 2004 our understanding is that the proposed Project would consist of a High Voltage Direct Current transmission line interconnecting Pacific Gas & Electric's (PG&E) Pittsburg Substation near Pittsburg, CA and PG&E's Potrero Substation in San Francisco. Although the Project has been studied for capacities of 400 MW to 600 MW, other capacities similar in magnitude are possible depending on the design parameters selected for the Project.

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, possible reduced costs to ratepayers as a result of more efficient dispatch of existing power resources in the Greater Bay Area, as well as the 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.

The CAISO is currently evaluating the long-term transmission requirements for the San Francisco and Greater Bay Area through the San Francisco Stakeholder Study Group (SFSSG). The CAISO considers the proposed Project to be a key transmission alternative within this stakeholder effort and is evaluating it as a long-term solution for serving load in the San Francisco and Greater Bay Area. As you know, the CAISO considers a number of key parameters in its assessment of selecting the preferred transmission alternative through its grid planning process. For the Trans Bay Cable



Project to be selected as the preferred long-term transmission alternative, the following is needed:

- The SFSSG determines a need date for an additional transmission project after the presently approved projects are in-service or as a substitute for a project;
- The Project would need to demonstrate that it is the most feasible reliability project among all options being considered by the SFSSG;
- The economic analysis of the Project demonstrates that it is the best choice;
- The in-service date of the Project is consistent with the reliability needs of the area;
- Successful review and support from the San Francisco Stakeholder Study Group members
- All technical issues have been adequately addressed in the Project's interconnection study being conducted by PG&E

In consideration of the importance of Babcock & Brown's continuing to develop the Project the CAISO remains committed to take the necessary steps that are needed to fully assess the merits of your project. As we have discussed with you, these evaluations include:

1. As requested by the San Francisco Stakeholder Study Group, the CAISO will evaluate the economic analyses included in the Need Studies you have submitted to the San Francisco Stakeholder Study Group. This evaluation may be conducted by the CAISO or through a retained consultant. If that economic evaluation confirms that the Project's estimated economic benefits exceed its estimated Annual Fixed Revenue Requirements, following consultation with the San Francisco Stakeholder Study Group and PG&E and receipt of their input, CAISO staff will recommend to the CAISO Board of Governors that the Project be approved as an economic project. CAISO staff will use its best reasonable efforts to bring this evaluation to a conclusion in a timely manner so that it can make its recommendations to the CAISO Board at their currently scheduled meeting of April 28, 2005. However, the CAISO cannot guarantee that this evaluation can be completed by this time, or that the CAISO Board will approve the Project on this basis.
2. As indicated above, PG&E is continuing Phase 2 of its San Francisco Peninsula Long Term Transmission Planning Study. At the San Francisco Stakeholder Study Group meeting on December 1, 2004 an interim Thermal Analysis report was presented which related load serving capabilities and thermal consequences on the transmission system for conditions with and without generation in San Francisco. Some possible transmission reinforcements, operating solutions and upgrades to San Francisco's transmission system were presented ("Reinforcements"). Also presented was an outline of planned future study efforts, estimated to be completed by February-March, 2005, which would attempt to determine the preferred long-term load serving capability option for the San Francisco area. This outline indicated that five additional long-term options would be analyzed and compared to the Reinforcements mentioned above. These additional options include (1.) do nothing, (2.) load management and/or distributed/renewable generation, (3.) a new 230 kV AC line from Potrero to Moraga, (4.)

the Babcock & Brown DC Line between Potrero and Pittsburg, and (5.) a new 230 kV AC line from Potrero to East Shore plus a reconductoring between East Shore and San Ramon plus a new 230 kV AC line between San Ramon and Tesla. A proposed matrix for evaluating all five of these options was distributed by the CAISO and comments thereon were requested. If this evaluation, undertaken in concert with CAISO staff, the San Francisco Stakeholder Study Group and PG&E, concludes that the Project is the preferred long-term load serving capability option for the SF area, then CAISO staff will recommend to the CAISO Board of Governors that the Project be approved as a reliability project. CAISO staff will use its best reasonable efforts to bring this evaluation to a conclusion so that it can make its recommendations to the CAISO Board at their meeting currently scheduled for April 28, 2005. However, the CAISO cannot guarantee that this evaluation can be completed by this time, or that the CAISO Board will approve the Project on this basis.

The CAISO encourages you to continue to move forward with the development of your Project so as to guarantee that we have a viable alternative to consider while we are undertaking the economic and reliability evaluations indicated above. In the meantime, the CAISO looks forward to continuing to work with you within the San Francisco Stakeholder Study Group forum.

If you would like to further discuss this issue, please contact me or call Armando Perez, Director of Grid Planning at (916) 351-4444.

Sincerely,



Jim Detmers  
Vice President, Grid Operations  
Acting Chief Operations Officer

cc: Marcie Edwards, CAISO  
Charlie Robinson, CAISO  
Jeff Butler, PG&E  
Armando J. Perez, CAISO

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Trans Bay Cable, LLC

Docket No. ER05-\_\_\_\_-000

State of California            )  
  )    SS:  
County of San Francisco    )

**VERIFICATION OF MICHAEL M. GARLAND**

I, Michael M. Garland, being duly sworn, depose and say that the statements contained in the Affidavit of Michael M. Garland on behalf of Trans Bay Cable LLC submitted in this proceeding are true and correct to the best of my knowledge, information and belief.

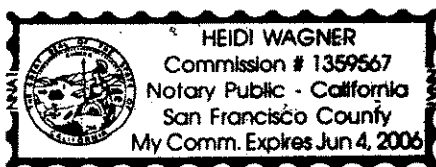
Signed this 18<sup>th</sup> day of May, 2005.

  
\_\_\_\_\_  
Michael M. Garland

Subscribed and sworn to before me  
this 18<sup>th</sup> day of May, 2005.

  
\_\_\_\_\_  
Notary Public

My commission expires: June 4, 2006



**EXHIBIT C**

**UNITED STATES OF AMERICAN  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

**Trans Bay Cable, LLC**

**Docket No. ER05-\_\_\_\_-000**

**NOTICE OF FILING**

**(May \_\_, 2005)**

Take notice that on May 19, 2005, Trans Bay Cable LLC ("TBC") tendered for filing with the Federal Energy Regulatory Commission (Commission), pursuant to Section 205 of the Federal Power Act and Part 35 of the Commission's Rules and Regulations, an Operating Memorandum dated May 16, 2005 among TBC, the City of Pittsburg, California and Pittsburg Power Company (the "Project Participants"). The Operating Memorandum sets forth the rate principles applicable to TBC and the rights and responsibilities pursuant to which the Project Participants will pursue the development, financing, construction and operation of a 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 (the "Project"). TBC states that it has served copies of this filing upon the California Public Utilities Commission, the California Energy Commission, Pacific Gas and Electric Company and the California Independent System Operator Corporation.

Any person desiring to intervene or protest this filing should file with the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. §§ 385.211 and 385.214). Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceeding. Any person wishing to become a party must file a motion to intervene. All such motions or protests should be filed on or before the comment date, and, to the extent applicable, must be served on the applicant and on any other person designated on the official service list. This filing is available for review at the Commission or may be viewed on the Commission's web site at <http://www.ferc.gov> using the "RIMS" link, select "Docket #" and follow the instructions (call 202-208-2222 for assistance). Protests and interventions may be filed electronically via the Internet in lieu of paper; see 18 C.F.R. § 385.2001(a)(1)(iii) and the instructions on the Commission's web site under the "e-Filing" link.

Comment Date:

**EXHIBIT D**

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that I have this day served a copy of the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

DATED this 19<sup>th</sup> day of May, 2005.

/S/ Robert L. Daileader, Jr. \_\_\_\_\_  
Robert L. Daileader, Jr.