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January 24, 2006 **BY HAND DELIVERY**

Docket Clerk
State of California Public Utilities Commission
505 Van Ness Avenue, Room 2001
San Francisco, CA 94102

Re: Order Instituting Rulemaking to Consider Refinements to and Further Development of the Commission's Resource Adequacy Requirements Program - R.05-12-013

Dear Sir/Madam:

Enclosed for filing is an original and five copies of the **JOINT PROPOSAL OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E), SAN DIEGO GAS AND ELECTRIC COMPANY (U 902 E) AND SOUTHERN CALIFORNIA EDISON COMPANY (U 338 E) ON LOCAL RESOURCE ADEQUACY REQUIREMENTS** submitted in connection with the above-referenced proceeding.

Please file the original and return the stamped copy in the envelope provided. Thank you for your assistance with this matter.

Very truly yours,

/s/
Arthur L. Haubenstock

ALH/dl

Enclosures

cc: President Michael R. Peevey
Administrative Law Judge Mark S. Wetzell
Official Service List for R.05-12-013

BEFORE THE
PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

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JOINT PROPOSAL OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E), SAN DIEGO GAS AND ELECTRIC COMPANY (U 902 E) AND SOUTHERN CALIFORNIA EDISON COMPANY (U 338 E) ON LOCAL RESOURCE ADEQUACY REQUIREMENTS

Pacific Gas & Electric ("PG&E"), San Diego Gas & Electric Company ("SDG&E") and Southern California Edison Company ("SCE") (collectively, the "IOUs") submit this joint proposal to address Resource Adequacy Requirements ("RARs") to meet local reliability needs ("Local RARs"), in accordance with the Commission's Phase 2 Resource Adequacy Decision. (D.05-10-042, at p. 81 ("Phase 2 RA Decision"); Order Instituting Rulemaking R. 05-12-013, at p. 8, n.6 (Dec. 15, 2005)("Dec. 15 OIR")). This proposal is intended to satisfy the objectives identified by the Commission ("Commission" or "CPUC") for the Local Resource Adequacy ("Local RA") program, laying out a path to define the bounds of the program as well as an annual cycle to implement its requirements. The Local RA program outlined herein would, after development through the Commission's workshop process and the final Commission order establishing Local RARs, become an integral part of the interim overall Resource Adequacy regime. The program would remain in place until future developments, such as the adoption of a capacity market, require its adaptation or replacement.

I.
OUTLINE OF PROPOSAL

The IOUs believe, consistent with the approach indicated by the Commission (Dec. 15 OIR at pp 4-5), that the Local RAR process should be incorporated within the overall Resource Adequacy process to the extent practicable, resulting in an integrated annual RAR demonstration by each Load Serving Entity ("LSE") that is subject to the Commission's jurisdiction ("CPUC-LSEs"). Before the annual process can begin, however, the Commission must first define the parameters of the Local RA program to achieve the appropriate balance of cost and reliability within its jurisdiction. An annual cycle of procurement and demonstrations would follow, implementing the Commission's vision until future developments, such as adoption of a capacity market.

Threshold Parameters. Prior to initiating the annual cycle, two threshold issues identified by the Commission must be addressed: the "overarching" goals of the Local RA program must be defined, and the "costs and benefits of alternative approaches to reliability criteria used to define the local obligation" must be evaluated. (Phase 2 RA Decision at p. 81.) The IOUs believe that a stakeholder process under the Commission's auspices is necessary to establish the right cost/benefit balance within the Commission's jurisdiction, and to address remaining basic questions. This stakeholder process will provide the Commission with a proper basis on which to set the basic parameters for defining local areas and the level of reliability that is to be achieved in those areas. Once the answers to these questions have been established, the cycle can begin, with annual identification of local areas and their needs, procurement to meet those needs, demonstrations showing LSE procurement, and backstop procurement as necessary to fulfill any residual needs or as necessary for mitigation of market power.

The IOUs also believe that the Local RA program should not increase the overall costs currently borne by ratepayers for local reliability.

Annual Cycle. The annual Local RAR cycle would consist of five basic steps: (A) definition of local areas and their procurement needs through an annual Local Resource Adequacy report addressing a ten-year horizon (the "Annual LRA Report"); (B) allocation of procurement responsibilities among LSEs; (C) procurement demonstrations by CPUC-LSEs to the Commission; (D) evaluation by the California Independent System Operator Corporation, Inc. ("CAISO") of the sufficiency of the aggregate demonstrations of the CPUC-LSEs, as well as any demonstrations by non-jurisdictional LSEs, and (E) backstop procurement by the CAISO as necessary to meet needs identified in the Annual LRA Report that were not satisfied through LSE procurement or the Reliability Must-Run process (which would continue to address local market power concerns and ensure that the most critical local reliability needs are met).

A. Defining Local Areas and Their Needs. In the first step in the annual cycle, the CAISO's Grid Planning Process would apply reliability standards within the Commission's cost/benefit parameters to delineate local areas and determine the overall resource needs in those local areas, incorporating stakeholder review and taking transmission solutions into account in determining the subset of needs that, consistent with the Commission's established cost/benefit balance, should be met through procurement. The Grid Planning Process would produce the Annual LRA Report, which would identify each local area and its specific needs, including the relative effectiveness of resources that could be used to address those needs, as well as anticipated changes to local areas and their needs over a ten year horizon.

B. Allocation Of Procurement Responsibilities. The needs of each local area would be apportioned between CPUC-jurisdictional and non-jurisdictional LSEs on an aggregate basis, based on their relative total load shares in each local area. The CPUC-jurisdictional entities' aggregate share of the local area needs in each IOU historic service territory would, in turn, be apportioned to each CPUC-LSE in proportion to its load share in that service territory,

consistent with the Commission's rate design and historic investment in the transmission system. CPUC-LSEs could procure their share of local needs through resources (or dispatchable demand-response ("DDR") and distributed generation ("DG") programs) in any of the local areas within that historic IOU service territory, within limits that would be established for the largest local areas to avoid over- or under-procurement.

For example, for PG&E's historic service territory, the CAISO would first allocate local needs identified in the Annual LRA Report between total CPUC-LSEs and non-jurisdictional LSEs, based on the relative total load shares of each group in each local area. Then the Commission would further allocate a share of the aggregate CPUC-LSE total obligation in the IOU historic service territory to each individual CPUC-LSE. That share, in terms of megawatts, would be computed as the CPUC-LSE's total forecast load in the PG&E service territory divided by the total CPUC-jurisdictional load in that service territory. Each CPUC-LSE could meet its obligation by procuring its assigned number of megawatts in any local area or combination of local areas within the PG&E historic service territory, within limits to avoid over- or under-procurement in the largest local areas.

C. Commission Evaluation of CPUC-LSE Demonstrations. The overall Resource Adequacy showing required of CPUC-LSEs would identify the local area resources meeting Local RARs. The Commission would evaluate the demonstrations, taking into account RMR, and allocating local area attribute credit from "long" Local RAR positions of CPUC LSEs pro-rata to "short" CPUC LSE Local RAR positions, with an administratively-set compensation for the transfer of the credit (or at actual cost if it can be demonstrated to exceed the administratively-set compensation level). The Commission would then report the results of its evaluation to the CAISO.

D. CAISO Evaluation & Backstop Procurement. The CAISO would determine whether the local area resources provided through CPUC-LSE demonstrations, non-jurisdictional showings, and RMR procurement[1] fully satisfy the needs identified in Annual LRA Report. The CAISO would then use its backstop procurement mechanism to the limited extent necessary to meet Annual LRA Report needs that were not satisfied. The CAISO's costs for resources procured on behalf of deficient LSEs (CPUC-jurisdictional or non-jurisdictional) would be billed directly to the Scheduling Coordinators ("SCs") responsible for those LSEs. If backstop procurement on behalf of deficient LSEs alone would not be sufficient to ensure that all Annual LRA Report needs are met,[2] the CAISO's additional procurement costs (beyond those incurred on behalf of deficient LSEs) would be allocated to all SCs responsible for the LSEs in the IOU historic service territory,[3] as well as any other SCs responsible for load in the local area in which the resources were procured.

The IOUs believe that the approach outlined above would result in an appropriate balance of local reliability and costs, as well as an equitable and implementable means of allocating the costs and burdens of meeting local reliability needs. This approach would provide LSEs with the opportunity to procure the needs that the Commission determines are appropriate, minimizing the CAISO's procurement role to the minimum essentials that cannot be contracted for within reasonable commercial terms or that LSEs simply fail to contract for themselves.

[1] RMR Condition 1 units should count toward reducing the need in local areas even though these types of units would not count toward any particular LSE's overall (115%) Resource Adequacy requirements without an additional contract, per the Energy Division Guidance Letter of December 21, 2005.

[2] This would occur only if efficiency factors of the resources procured by LSEs were not sufficient to address the contingencies identified in the Annual LRA Report.

[3] This allocation would be of cost and credit towards meeting Local RARs, but would not be for purposes of meeting overall (115%) Resource Adequacy requirements. For purposes of the overall (115%) Resource Adequacy requirements, the megawatts of the underlying resource would continue to count towards the transferor's obligation, rather than the transferee's obligation.

II.
THRESHOLD QUESTIONS

The Commission has clearly determined that any Resource Adequacy program must be premised on an assessment that its benefits merit its costs, stating as follows:

> [T]he concept embodied in the phrase "reliability at any cost" is not a policy option. Ultimately, measures that are proposed to promote greater grid reliability should be evaluated by weighing their expected costs against the value of their expected contribution to reliability.

(Phase 2 RA Decision at p. 8.) All Resource Adequacy measures, including Local RARs, must meet this fundamental test. The goals of the Local RA program, including the criteria adopted to achieve those goals, must be examined through the lens of the appropriate cost/benefit balance, as determined by the Commission.

The cost and extent of the Local RA program will fundamentally depend upon the definition of local reliability areas, the balance struck between cost and risk in those areas, and the choices made as to when transmission or generation solutions best provide for the needs of those areas. These questions require a mix of complex policy and technical decisions, including exercises of discretion in the integration and application of planning and operation standards and the degree of mitigation desired for contingencies relative to their likelihood of occurrence. Discretion as to application of standards, interpretation of terms, and degrees of desired redundancy must be exercised, to the extent of the Commission's jurisdiction, within the cost/benefit framework that is ultimately established by the Commission. The requisite terms and conditions for procurement vehicles, whether LSE bilateral contracts or CAISO backstop mechanisms, must be established by the Commission to ensure that local reliability goals are achieved, including adequate redress of market power. Lastly, the procurement role played by the CAISO will have substantial impact on the cost of meeting local reliability needs, and the

criteria the CAISO will use to select resources should also be determined in advance of the CPUC-LSE procurement cycle.

A. Definition of Local Reliability Areas.

In essence, a local reliability area is an area that cannot reliably meet the needs of its load solely through transmission from sources outside of the area. Reliability is assessed under various conditions of decreasing likelihood, ranging from normal system operation to operation after the simultaneous loss of multiple system elements (including transmission and generation equipment). The acceptable level of reliability is thus critical to the demarcation of each local area, as are changing assumptions as to the load projections for the area and the transmission resources and operational measures available to the area.

1. The Application & Interpretation of Reliability Standards

The standards that have been in use by CAISO for grid planning, known as the "Grid Planning Standards," incorporate reliability, load projection and transmission assumptions, and are well-established, accepted and understood. The Grid Planning Standards require that the system is planned and operated to withstand the loss of single critical system elements ("single contingency events") without disruption of service, with certain limited exceptions. The Grid Planning Standards provide flexibility for mitigating multiple contingencies (in which multiple critical system elements fail), allowing consideration of relative costs and benefits, including the possibility of rerouting power or shedding load to maintain the overall system (such as, but not limited to, automated measures called Remedial Action Schemes ("RAS") and manual switching by operators). Standards established by NERC and WECC are used within the Grid Planning Standards for evaluating the reliability of local areas.

The further application of NERC and WECC standards requires interpretation and judgment calls as to acceptable responses to multiple contingencies, including the flexibility,

speed, error rate, degree and robustness of mitigation, as well as the extent to which responses must address likelihood of further contingency events. These decisions affect choices as to whether transmission solutions (including both operational means and transmission enhancements), generation solutions or load interruption meet the desired level of reliability, and thus the extent and cost of the Local RA program.

Any variation from the Grid Planning Standards intended to set the baseline for Local RARs must be made consistent with the Commission's determination of the appropriate balance between the possibility of customer interruptions and the cost to those customers of addressing less-frequent contingencies. The CAISO's "Local Capacity Technical Analysis" (September 23, 2005) was conducted outside of the Grid Planning Process (which implements the Grid Planning Standards, as discussed below). It did not reflect the assumptions of, nor flexibility provided by, the accepted Grid Planning Standards, nor was it assessed through the normal stakeholder review that applies to the Grid Planning Process. That study incorporates assumptions regarding permissible levels of customer interruption that have not been reviewed by the Commission and have not been widely accepted by Participating Transmission Owners ("PTOs") or stakeholders, and thus presumes a cost/benefit balance that has not been demonstrated to be consistent with any parameters approved by the Commission.

It is essential that the Commission clearly define its desired balance of reliability and cost for the Local RA program before the process of defining local areas and their needs begins, so that all concerned can be confident that the Annual LRA Report will fully reflect that framework. Any process that will delineate local areas and their needs will necessarily have to evaluate confidential information about transmission and generation that could be used to competitive advantage by those involved in market transactions. The process must therefore be conducted with the input of marketing entities, but must comply with the requirements of the Federal

Energy Regulatory Commission's Orders 888 and 2004. Market participants can thus only be assured of the consistency of the process with the Commission's determinations if the ground rules are established in advance, so that Commission staff, in its role as a stakeholder, can represent that the process adhered to those standards.

2. The Importance of a Single Process To Identify Grid Needs

The demarcation of local reliability areas and their needs is an extension of the analysis carried out through the annual Grid Planning Process. In this process, the PTOs are the "Transmission Planners," as that term is defined in the NERC Functional Model, and the CAISO is the "Planning Authority." The PTOs perform the transmission planning studies under the oversight of the CAISO and with review by stakeholders, including Commission staff. Specific existing and planned generating units and transmission facilities are assumed to be available in future years to serve forecasted load demands. The CAISO reviews and approves the transmission planning studies, including plans for addressing any reliability issues. The Grid Planning Process results in a rolling ten-year outlook, constituting an accepted and stakeholder-evaluated vision for the CAISO-controlled grid.

If the Annual LRA Report and its underlying studies setting forth local area definitions and their needs are performed outside of the Grid Planning Process, without its established stakeholder review procedure, the inevitable result will be conflicting assumptions and conclusions, causing unnecessary confusion, dispute, delay and inefficiency. Further discrepancies and discord would result if the solutions that PTOs can provide to satisfy or ameliorate local area needs are evaluated in two separate processes. These solutions must be assessed as part of the panoply of options and issues reviewed in the Grid Planning Process and subjected to review by stakeholders, including Commission staff. The continued development of the CAISO-controlled grid as an efficient, reliable backbone of California's economy, assured

through a meaningful stakeholder process that includes Commission staff, cannot withstand multiple and divergent planning tracks. The delineation of local areas and their needs must therefore be seamlessly integrated into the Grid Planning Process, and the Annual LRA Report must be a product of that process, rather than a unilateral extrapolation from it.

3. Dynamics of Local Area Delineations Over Time

As noted above, the definition of local areas and their needs depends on projected load forecasts and transmission system attributes. These conditions change over time as loads change and the transmission system changes. LSEs procuring resources to meet Local RARs through multi-year contracts, consistent with Commission policy and economic objectives, need assurance that the contracted resources will continue to fulfill the LSEs' obligations. The Grid Planning Process, which produces a rolling ten-year outlook, is well situated to provide the basis for longer-term projections in the Annual LRA Study.

Initially, the local area definitions and their needs should be determined through analysis of the worst stress condition, e.g., summer, and the resulting needs determination should apply throughout the year. Once the Local RA program has been well-established, the Commission may wish to revisit whether Local RARs should be divided into smaller intervals, such as seasonal or monthly periods, to reflect the substantial differences in both load needs and transmission system concerns that pertain at different times of the year.

B. Terms and Conditions of Procurement Vehicles.

The terms and conditions of the procurement vehicles used to satisfy the local needs identified in the Annual LRA Report, whether bilateral contracts entered into by LSEs or backstop procurement mechanisms utilized by the CAISO, must equally require the resources that have been procured to meet all of the desired objectives. These objectives must include the availability needed for local reliability, operational flexibility, terms of any allowable

substitution, and, importantly, measures to mitigate the market power that the resources might otherwise exhibit. The latter criterion should be evaluated in the context of the ongoing development of the CAISO's Market Redesign and Technology Upgrade ("MRTU"), and may need to be adapted to coordinate with MRTU provisions that are ultimately approved by the FERC.

C. CAISO Procurement Role.

The approach outlined in this proposal by the IOUs anticipates that LSEs will conduct as much of the procurement needed to meet local reliability concerns as possible. However, CAISO procurement will remain necessary to address market power and to backfill on behalf of deficient LSEs. The IOUs anticipate that RMR will continue to play a role to ensure that the most critical resources needed for local reliability are secured and their market power has been addressed, although RMR would be reduced to the extent that RMR units accept commercially reasonable contract terms, eventually leading to the phase-out of RMR. The CAISO's backstop procurement on behalf of deficient LSEs, or to cure the lack of effectiveness of LSE-procured resources to meet the needs identified in the Annual LRA Report, must be governed by appropriate selection criteria. The weight that the CAISO should give to relevant factors when choosing between resources, including effectiveness, size, availability metrics, and energy cost, should be considered through the Commission's workshop process and defined by the Commission's order implementing the Local RA program.

D. Commission Workshops Will Provide an Appropriate and Adequate Basis For Deciding Threshold Questions.

The IOUs believe that all parties, working together through the Commission's workshop process, can forge a common understanding of the appropriate process for defining local areas, their needs and the appropriate and reasonable means to meet those needs. A suggested slate of workshop subjects is provided in Section V of this proposal.

III.
ANNUAL CYCLE

Planning for the implementation of the annual Local RAR cycle for 2007 and beyond can proceed alongside resolution of the basic parameters of the program. The cycle would be closely coordinated with, and to the extent practicable incorporated into, the overall annual Resource Adequacy cycle, taking into consideration the CAISO's RMR process and schedule.

A. Annual Local Needs Study.

The annual Local RAR cycle would begin with development of the Annual LRA Report through the established Grid Planning Process, as defined in Section II. A above. The Annual LRA Report would identify local areas by both PTO and IOU historic service territories, and would also identify each resource that could be used to relieve contingencies of concern, including their relative effectiveness. The report would project the likely changes to local area designations and their needs over a ten-year horizon, providing LSEs with the information that they would need to make long-term contracting decisions.

B. Allocation of Responsibilities to Meet Local Needs.

The allocation of responsibilities to meet the needs identified in the Annual LRA Report would take place in two stages. In conjunction with its release of the Annual LRA Report, the CAISO would release a report allocating responsibilities between non-jurisdictional entities and, on a collective basis, CPUC-LSEs, in accordance with their aggregate load share in local areas. In the second stage, the Commission would further allocate the total local area responsibilities collectively apportioned to CPUC-LSEs to each individual CPUC-LSE, in accordance with CEC forecasts of its relative load share in each IOU historic service territory in which the CPUC-LSE serves load. This allocation methodology is consistent with the historic investment in the grid, which was paid for by load without any intention of differentiated pricing due to transmission

constraints, as well as consistent with the Commission's rate design, which does not distinguish between costs of service in locally constrained and non-constrained areas.

C. Prioritization of LSE Procurement.

The CPUC-LSEs, having been issued their proportional share of local area requirements, would proceed to procure resources in any of the local areas within the IOU historic service territory in which they serve load,[4] provided that procurement distribution limitations for the largest local areas (such as the Bay Area and Fresno), to be defined through the Commission's workshop process, are met to avoid over-procurement in those areas and under-procurement in others. This approach would allow smaller CPUC-LSEs to meet their obligations without having to procure multiple fractional shares in multiple areas, and would mitigate market power concerns when larger LSEs have fully procured the resources needed in particular local areas. The Local RA process will need to allow CPUC-LSEs to take the initial results of the CAISO's RMR process into consideration in their acquisition process, entering into bilateral contracts with RMR units that accept commercially reasonable terms. RMR will continue to serve as the market power mitigation procurement tool for such units to the extent that LSEs cannot reach bilateral agreements with those units.[5]

If any CPUC-LSE is unable to acquire 100% of its share of Local RARs, having made every commercially reasonable effort to do so, it may petition the Commission for relief of its requirement on the grounds that it could not obtain sufficient resources at commercially reasonable terms. The petition would have to demonstrate to the Commission that the CPUC-LSE issued a commercially reasonable Request For Offer ("RFO"), and that the CPUC-LSE could not contract with sufficient resources, due to either: (i) resources demanding higher

[4] CPUC-LSEs with load shares in multiple historic IOU service territories would have separate obligations for each such territory.

[5] In Section V, the IOUs propose that integration of RMR and Local RA processes be a topic for workshops.

compensation than would be available through CAISO backstop procurement; (ii) resources demanding more than the Commissioned-determined compensation level for transferred local attributes, as discussed below; or (iii) lack of response to the RFO by sufficient resources. To substantiate its claims, any CPUC-LSE petitioning the Commission for relief from a penalty would have to provide the Commission with the terms of its relevant RFOs and the responses it received, under seal.

D. Local RAR Demonstrations & Commission Evaluation.

Each CPUC-LSE would incorporate its Local RAR demonstration into its annual overall Resource Adequacy demonstration. The Commission would review each demonstration to determine compliance with both overall Resource Adequacy and Local RARs. To the extent that any CPUC-LSE demonstrates that it has procured a larger amount of local area resources than had been required of it, and any CPUC-LSE has not procured sufficient local area resources to meet its requirements, the Commission would allocate a credit for the local attribute to those CPUC-LSEs that did not meet their full Local RAR demonstration, on a pro-rata basis in accordance with the deficient CPUC-LSE's load share in the IOU historic service territory in which the excess resources are located.[6] The Commission would administratively determine a compensation level for the transfer of credit for these local attributes.[7] This unbundling of the local attribute would also facilitate the purchase of small quantities of local attribute credit, which may assist smaller CPUC-LSEs to meet the Local RARs. The Commission would assess a penalty of three times the administratively-determined transfer compensation level to those CPUC-LSEs that, after receipt of their proportional share of "excess" local attributes, still fail to

[6] The credit of local attributes to deficient CPUC-LSEs should not exceed the deficiency requirement (e.g., if a CPUC-LSE was deficient 50 MW of local attributes in its Local RAR demonstration, the amount of credit transferred by the Commission from long CPUC-LSEs should not exceed 50 MW).

[7] The administratively-determined compensation level for the transfer of credit for the local attribute would be established in advance, preferably through the CPUC workshop process.

meet their full 100% Local RAR allocation.[8] This penalty should be used to pay for any costs of CAISO backstop procurement that are needed above the deficiency level to satisfy effectiveness factor needs that were not met by LSE procurement or by RMR. The Commission would then forward the final results of its evaluation of the CPUC-LSE demonstrations to the CAISO.

E. CAISO Procurement & Cost Allocation.

The CAISO would determine whether the needs identified in the Annual LRA Report had been met through a combination of CPUC-LSE demonstrations, equivalent demonstrations by non-jurisdictional entities in accordance with the requirements of their own jurisdictions, and the results of the RMR process. If any requirements specified in the Annual LRA Report were not met by LSE and RMR procurement, the CAISO would use its backstop procurement mechanism to acquire resources necessary to meet the residual needs. The CAISO would allocate the costs of the backstop procurement up to the level of collective deficiencies of LSEs to the Scheduling Coordinators for those deficient LSEs, in proportion to their deficiencies (for CPUC-LSEs, after crediting those LSEs with local attribute transfers from other CPUC-LSEs). The megawatts procured by the CAISO should count towards the overall (115%) Resource Adequacy requirements of the deficient LSEs that pay the cost of procurement, in proportion to their payment.

If procurement for aggregate deficiencies would be insufficient to meet the needs identified in the Annual LRA Report (due to the effectiveness factors of LSE-procured resources), the CAISO would allocate the costs of additional backstop procurement in each local area to all Scheduling Coordinators for CPUC-LSEs in the IOU historic service territory as well as any other SCs responsible for load in the local area. The megawatts procured by the CAISO in this instance on behalf of CPUC-LSEs should be counted towards all CPUC-LSEs' overall

[8] The penalty would not be assessed to a deficient CPUC-LSE that previously received a waiver from the CPUC for meeting its Local RAR requirement, as described above in III.C.

(115%) Resource Adequacy requirements in the IOU historic service territory in which the megawatts were procured, in proportion to the CPUC-LSEs' load share in that service territory.

IV.
RESPONSES TO COMMISSION QUESTIONS

In D.05-10-042, the Commission listed eight areas of specific interest that it intends to address through the upcoming Local RA program proceedings. Resolution of these issues is necessary, in the words of the Commission, to complete "…the development and the evaluation of the various details of the local RAR component [of the RAR policy framework] so that it can be implemented in 2007." (D.05-10-042 at p. 81.) The following is a brief description of how this Joint IOU Proposal addresses each of these areas of interest.

A. Information regarding the appropriate overarching policies of local RAR.

The IOU proposal provides a clear and implementable approach to achieving Local RARs. This proposal addresses the designation of local areas and their needs by the CAISO through the Grid Planning Process, based on a cost/benefit balance established by the Commission; the share of responsibility of each CPUC-LSE by the Commission; the means by which CPUC-LSEs can comply with their requirements; the penalties associated with failure to meet the requirements; and a means to address some of the market issues associated with the procurement of this newly defined product in limited markets by a myriad of LSEs. Finally, the Joint IOU proposal describes how the CAISO can meet its reliability needs in the event of failure by the LSEs, individually or in the aggregate, to procure or otherwise provide sufficient resources to meet local reliability criteria. This proposal provides a direct, simple, and efficient way to implement the Local RA program.

B. Costs and benefits of alternative approaches to reliability criteria used to define the local obligation.

Under the Joint IOU proposal, the CAISO Grid Planning Process would establish criteria for reliably serving load in transmission constrained areas by examining the reliability of the system under extreme demand, and under various failures of system elements. This analysis would allow the Grid Planning Process to establish the combinations of transmission and generation sufficient to service the load in these constrained areas without unduly jeopardizing system reliability, using the Commission's determination of the appropriate balance of costs and benefits as the context for interpreting reliability standards and applying them within the Commission's jurisdiction. The local area capacity requirement debate during the Commission's Resource Adequacy Workshop process focused almost exclusively on the level of generation necessary in a constrained area to satisfy the CAISO's proposed criteria. However, other means exist that can address the reliability needs in constrained areas, potentially lowering the need for procurement. Transmission operational measures or additional transmission elements, for example, could alleviate some of the constraints; where permissible under reliability standards and acceptable to the Commission, load-shedding plans (such as RAS or manual switching) can also reduce local area needs.

The Local RA program must be premised on a cost-effective resolution of local reliability needs, incorporating feasible and economic transmission measures that would meet reliability concerns at a lower cost than generation. Similarly, after the analysis identifying needs has been performed, demand reduction can be achieved through some demand side programs, including DDR and DG, consistent with meeting reliability needs. These latter solutions should also be available to LSEs in lieu of generation in the Local RAR showings, consistent with the Commission's Phase 2 RA Decision. In summary, the designation of local areas and their needs

should incorporate the Commissions' cost/benefit determinations and cost-effective transmission solutions to lower the requirements imposed on CPUC-LSEs, and CPUC-LSEs should have the option to utilize the most cost-effective means at their disposal to satisfy the remaining reliability needs.

C. Means of preventing or mitigating market power.

Requirements for capacity in load pockets, some of which can be quite small compared to the CAISO system as a whole, can easily lead to one or more generator owners being pivotal as a supplier. The potential for market power is substantial, and a mechanism to mitigate this market power is essential in the process of establishing a new requirement for LSEs, which will be faced with the alternative of either (i) purchasing their share from this limited supply or (ii) the potential of a steep penalty and/or the cost of backstop procurement on their behalf. The Joint IOU proposal would mitigate market power in two ways: by establishing a cap on the cost that a CPUC-LSE must pay to procure the local attribute of capacity, and by providing for CAISO backstop procurement for resources that refuse commercially reasonable terms (maintaining RMR for those resources that are essential to the most critical local reliability needs, and using a more flexible backstop procurement mechanism to complete procurement of needs that had not been met by the combination of LSE and RMR procurement). Furthermore, by ensuring that long positions of CPUC-LSEs will be credited to short LSEs with an administratively-determined compensation level for the transfer of credit for the local attributes, incentives for withholding local capacity will be mitigated.

D. Mechanisms that allow LSEs, especially smaller ones, to acquire capacity to meet their localized obligations.

The Joint IOUs' proposal provides several mechanisms for CPUC-LSEs to use in meeting their Local RARs. First, it would allow CPUC-LSEs to contract directly for RAR capacity with local attributes in any local area in the IOU historic service territory in which it serves

load, subject to distribution limitations to prevent over-procurement in the largest local areas and under-procurement in others. Second, it would allow CPUC-LSEs (and, potentially, generators) that are long in RAR capacity with local area attributes to unbundle and transfer the local area attribute of their Resource Adequacy capacity to CPUC-LSEs that are short (i.e., deficient) in meeting their Local RARs, while allowing the entity transferring the local area attribute to continue to count the capacity of the resource toward its general (i.e., the 115%) Resource Adequacy requirement. Third, to the extent that long CPUC-LSE local area positions are not sufficient to offset fully the short CPUC-LSE local area positions, the proposal provides for the CAISO to procure the residual local area obligations and charge the costs of procurement to the deficient CPUC-LSEs, through their responsible Scheduling Coordinators.

E. Whether there is a need for waivers and, if so, what form should they take.

The Joint IOU proposal provides for a waiver request mechanism for situations in which either: (1) a CPUC-LSE cannot meet its Local RARs through procurement at a cost equal to or less than the administratively-established value of the local attribute or the cost of CAISO backstop procurement, or (2) the needed local area capacity is not available or offered for sale. The CPUC-LSE would be required to make its waiver request to the Commission in advance of the year-ahead local area showing. The waiver request would have to demonstrate that the CPUC-LSE actively solicited the market for all products that would meet its Local RARs, and either: (1) received bids with prices in excess of the administratively-established local attribute value, or (2) did not receive bids. In the event that the Commission grants a waiver, the CPUC-LSE would not be subject to a compliance penalty, although it would be required to pay for any CAISO backstop procurement costs necessitated by its deficiency.

F. Cost allocation issues.

The Joint IOU proposal allocates costs of the Local RA program in accordance with the Commission's rate design and the historic investment in the grid, which did not differentiate between local and other areas while maintaining cost allocation by historic IOU service territory. It would allow the Commission to determine the compensation level for local attributes and equitably provide CPUC-LSEs that cannot meet their Local RARs with local attribute credit from long CPUC-LSEs.

G. Whether the MOO mechanism should be retained until the CAISO has authority to enter into backstop local capacity contracts.

The Joint IOU proposal does not take a position on whether the current FERC-imposed Must Offer Obligation ("MOO") should be retained until the CAISO has established an alternative authority to contract for, or designate, local area units to provide local area services. The IOU's Local RA proposal contemplates that the CAISO will have a backstop procurement authority to acquire local resources to address deficiencies in meeting the local area needs that have been endorsed by the Commission.

H. Assurance that the need for transmission upgrades to address load pockets is considered and weighed against the need for local capacity.

The Joint IOU proposal recommends that an Annual LRA Report, determining local areas and their needs within the cost/benefit framework established by the Commission, be produced through the CAISO's Grid Planning Process. The Grid Planning Process is the established and accepted process for evaluating the state of the grid and of transmission upgrades. The seamless integration of the Grid Planning Process with the determination of local areas and their needs, consistent with Commission's guidance, will ensure efficient and effective evaluation of the future of the grid and avoid the conflict and confusion of duplicative and potentially divergent forecasts. The Annual LRA Report would thus have

incorporated those transmission solutions that can reliably and cost-effectively reduce local procurement needs, providing CPUC-LSEs with a clear procurement target (including effectiveness factors for resources that can be procure to address local area concerns). It will also provide CPUC-LSEs with the Grid Planning Process' ten-year perspective, offering an overview of anticipated future local area definitions and needs that can form a reasonable basis for long-term contracting to serve those needs. The Annual LRA Report would also benefit from the established stakeholder review built into the Grid Planning Process, providing Commission staff and others with a regular, structured opportunity to analyze the proposed definitions of local areas and their needs in the context of the evaluation of the grid and its future.

V.
WORKSHOP TOPICS

The IOUs propose that the Commission hold workshops on the following topics to develop further the basis for its decision establishing the Local RAR program:

- Definition of Local Areas and Their Needs Through the Grid Planning Process, Including Identification, Interpretation and Application of Appropriate Standards and Appropriate Cost-Benefit Tradeoffs
- Effectiveness Factors & Accuracy of Procurement to Address Contingencies
- Allocation of Local Requirements
- Criteria for CAISO Backstop Procurement
- Establishing Limits on Procurement in Largest Local Areas to Avoid Under- or Over-Procurement
- Determination of Compensation Levels for Local Attributes
- Integration of Local Requirements and the RMR Process
- Minimum Requisite Local Requirement Procurement Terms & Conditions
- Determination of Penalties & Process for Evaluating Waivers

VI.
ANNUAL LOCAL RAR CYCLE

Overall Steps in Local Process

1 Local Area Definition & Initial Needs Determination Evaluated Through Grid Planning Process.

2 Procurement & Transmission Solutions Evaluated Through Grid Planning Process.

3 Annual LRA Study Issued Through Grid Planning Process, Including Local Area Definitions, Local Area Needs, and Identification of Resource Effectiveness to Meet Needs. Initial Results Of Local Area Reliability Study for RMR Released.

4 CAISO Allocates Local Requirements Between CPUC & Non-CPUC Jurisdictional Entities. CAISO Issues Requests For Proposals to Provide RMR.

5 CPUC Allocates Local Requirements to CPUC-LSEs in Proportion to Load Share in IOU Historic Service Territory.

7 LSEs Procure to Meet Their Local Obligation. LSEs May Contract to Offset RMR Needs.

8 CAISO Finalizes RMR Needs, After Reduction for LSE Procurement.

9 CPUC-LSEs Unable to Procure to Meet Their Local Obligation May Petition CPUC for Waiver Due to Market Power or Lack of RFO Response.

10 Energy Division Issues Recommendation Letters for LSEs Determined Unable to Procure on Commercially Reasonable Terms.

11 LSEs File Year-Ahead Compliance Demonstration Meeting 90% of May-Sept RARs & 100% of Jan-December Local RARs.

12 CPUC Reviews Demonstration to: 1) Determine Whether any CPUC-LSE Is Deficient; 2) Allocate Long Local Attribute Positions to Short Local Attribute Positions; and 3) Determine if CPUC-LSEs are Deficient When Considered in Aggregate.

13 CPUC Issues Penalties to CPUC-LSEs That Remain Deficient After Transfer of Local Attribute Credits From Long Attribute Positions.

14 CAISO Reviews Total Compliance by all LSEs, Determines Whether Annual LRA Report Needs will be Met Through LSE Procurement, RMR Procurement, and CAISO Backstop Procurement for Deficient LSEs; if not, Determines Residual Procurement Required for Annual LRA Report Needs.

15 CAISO Allocates Costs of Backstop Procurement to Scheduling Coordinators for Deficient LSEs and Residual Procurement to Scheduling Coordinators for all LSEs in IOU Historic Service Territory in Proportion to Load Share. LSEs Can Use CAISO Procurement Towards Month-Ahead RA Demonstrations.

VII.
CONCLUSION

The IOUs believe that the Local RA program outlined herein would satisfy the Commission's intentions, and result in a fair and equitable process assuring cost-effective local reliability. The Commission's workshop process will allow the full development of this proposal and the issues it identifies, ultimately providing the Commission with the record it needs to form the basis of an order instituting Local RARs. The IOUs look forward to actively participating in this process, and to bringing the Commission's intentions to reality within the schedule envisioned by the Phase 2 RA Order.

Respectfully submitted,

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CERTIFICATE OF SERVICE BY ELECTRONIC OR FIRST CLASS MAIL

I, the undersigned, state that I am a citizen of the United States and am employed in the City and County of San Francisco; that I am over the age of eighteen (18) years and not a party to the within cause; and that my business address is Pacific Gas and Electric Company, Law Department B30A, 77 Beale Street, San Francisco, California 94105.

I am readily familiar with the business practice of Pacific Gas and Electric Company for collection and processing of correspondence for mailing with the United States Postal Service. In the ordinary course of business, correspondence is deposited with the United States Postal Service the same day it is submitted for mailing.

On the 24th day of January 2006, I served a true copy of:

JOINT PROPOSAL OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 E), SAN DIEGO GAS AND ELECTRIC COMPANY (U 902 E) AND SOUTHERN CALIFORNIA EDISON COMPANY (U 338 E) ON LOCAL RESOURCE ADEQUACY REQUIREMENTS

[XX] By U.S. Mail – by placing it for collection and mailing, in the course of ordinary business practice, with other correspondence of Pacific Gas and Electric Company, enclosed in a sealed envelope, with postage fully prepaid, addressed to all parties on the official service list for R.05-12-013 without an e-mail address.

[XX] By Electronic Mail – serving the enclosed via e-mail transmission to each of the parties listed on the official service list for all parties on the official service list for R.05-12-013 providing an e-mail address.

I certify and declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed in San Francisco, California on the 24th day of January, 2006.

/s/
DONNA LEE