BEFORE THE PUBLIC UTILITIES COMMISSION OF THE

STATE OF CALIFORNIA

Order Instituting Rulemaking Regarding Policies, Procedures and Incentives for Distributed Generation and Distributed Energy Resources.	))))	Rulemaking 04-03-017 (Filed March 16, 2004)

SOUTHERN CALIFORNIA EDISON COMPANY'S (U 338-E) COMMENTS ON INTERIM ORDER ADOPTING POLICIES AND FUNDING FOR THE CALIFORNIA SOLAR INITIATIVE

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Dated: **January 3, 2006**

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I. INTRODUCTION

Pursuant to Article 19 of the Commission's Rules of Practice and Procedure, Southern California Edison Company (SCE) submits the following comments on the Draft Decision of ALJ Malcolm and Commissioner Peevey Adopting Policies and Funding for the California Solar Initiative dated December 13, 2005 (Draft Decision). The Draft Decision follows the recently adopted Decision 05-12-044 which increased the solar photovoltaics (PV) portion of the SGIP budget by $300 Million for 2006. This Draft Decision proposes to provide an additional $2.85 Billion in ratepayer-funded incentives for solar projects over ten years.[1] Specifically, the Draft Decision would provide $2.5 Billion in incentives for commercial and existing residential building (CERB) projects, funded through investor-owned utility ratepayer distribution rates, and $350 Million in incentives for new residential developments, funded through Public Goods Charge monies. SCE's comments will focus on the CERB component of the program.

As the nation's leading purchaser of renewable power, SCE is supportive of renewable energy that will contribute to the diversity of energy resources and help the State meet its energy needs in a cost-effective and environmentally sustainable manner. However, SCE cannot uncritically support an

1 Details of the CSI program the Draft Decision proposes to adopt are described in Appendix A to the Draft Decision titled "Revised Joint Staff Proposal to Implement a California Solar Initiative," hereinafter referred to as "Revised Staff Proposal."

unnecessarily precipitous commitment of $2.5 Billion in additional ratepayer funds for the long-term extension of a solar program that has not yet proven to be cost-effective. In order to achieve the purported benefits of investing in solar rooftop installations, including resource diversity, peak power production, and GHG emission reductions, PV panels must be installed at a location and in a manner so as to produce kWh efficiently and cost-effectively. This requires a program design that includes performance-based incentives, mandatory eligibility requirements and strict installation standards, and an opportunity to reassess program value. The Draft Decision, however, defers resolution of such key program elements to future workshops.

The CSI as currently designed would provide billions of dollars in incentives to achieve 3,000 MW of "installed capacity," irrespective of the performance, operating efficiency, or cost-effectiveness of the installations. As evidenced by evaluation of the Self Generation Incentive Program, such a structure is fundamentally flawed, and will not produce net benefits to ratepayers or society as a whole. The Commission must structure the CSI in a manner which will actually produce the GHG emissions reductions and resource diversity benefits that form the basis for the program.

SCE also urges the Commission to work with the Legislature to adopt a more equitable funding source. In contrast to SB 1, which would have required that both Investor-Owned Utilities (IOUs) and municipal utilities fund the Million Solar Roofs Initiative, the Draft Decision places the entire cost burden for the CSI program on IOU ratepayers. To the extent that the policy basis for increasing funding for solar PV is the perceived environmental benefits it provides, those benefits inure to all residents of the State and the cost associated with obtaining the benefits should not be borne exclusively by IOU ratepayers. SCE recognizes that the Commission has no direct authority over municipal utilities. However, in its decision in this proceeding, the Commission should explicitly urge the Legislature to adopt these same requirements for municipal utilities, or alternatively, to adopt a broader funding source for the CSI so that its costs are not borne unfairly by only IOU ratepayers.

Lastly, SCE urges the Commission to postpone committing to a firm long-term funding level until key issues are addressed. The Draft Decision puts the proverbial cart before the horse, funding a California Solar Initiative (CSI) before critical elements – elements which would themselves determine the appropriate level of funding and protect ratepayer interests – are addressed. For example, the Draft

Decision ignores the ongoing cost-benefit work in R.04-03-017, despite the Joint Staff's earlier representations that this cost-benefit analysis would be incorporated into the CSI. SCE maintains that the Commission should not embark on this expensive, long-term initiative without first reviewing the costs and benefits of the program, including a full consideration of its likely effects on IOU electricity rates.

The Draft Decision also proposes future study of performance-based incentives, auction-based incentives, the impact of federal tax credits on decisions to invest in solar projects, metering requirements, low-cost financing options, energy efficiency retrofits, and even the Commission's strategy to achieve the stated goal of CSI – creating a competitive solar industry. SCE urges the Commission to address these issues *before* committing an additional $2.5 Billion in ratepayer monies to subsidize a technology that is not yet cost-effective or to fund a program with no strategy for long-term success. These are fundamental issues that must be addressed before the Commission can make an informed decision regarding an appropriate funding level. The Commission has already adopted a $300 Million increase in solar PV Self Generation Incentive Program (SGIP) funding for 2006 and thus there is no immediate need to adopt a long-term funding level for the CSI. The Commission should use 2006-2007 to resolve the critical issues above before committing to a total funding level.

In summary, SCE recommends that the Commission take a number of steps to enhance the chances for ratepayer benefit and program success. The Commission should:

- Structure the CSI around performance-based incentives, and adopt an interim performance-based incentive framework with 50% of the rebate paid up-front based on estimated performance and the remainder held back for five years;
- Require strict eligibility and installation standards;
- Institute mid-term assessments of the program with the opportunity for program modification;
- Work with the Legislature to establish a more equitable funding source or adopt the same program requirements for municipal utilities; and
- Postpone adopting a firm long-term funding level until a cost-benefit analysis is completed and key program design elements are addressed.

II. COMMENTS

A. The Commission Must Adopt Measures to Safeguard the Ratepayers' Investment and Enhance the Probability of Program Success.

1. The CSI Must Be Structured Around a Performance-Based Incentive Program.

The Draft Decision states that the Commission intends to explore performance-based incentives (PBI), but that "until such time as the Commission makes a determination on PBI, the CSI would continue to provide incentives on the basis of installed capacity."[2] As mentioned above, the Commission intends to sponsor workshops to resolve numerous issues related to PBI design, and thus there is no firm timeline for implementing PBI. Implementing PBI should be the Commission's first priority in establishing the CSI.

In proceeding with its program design, the Commission should be mindful that the structure of incentive mechanisms can have serious consequences for behavior and, therefore, for program performance. For example, during the early 1980s, financial incentives to encourage the development of wind-powered generation were structured as investment tax credits. As a result, there was much capital investment in California's wind power industry, but many of these early turbines were hastily installed without much regard for their performance in generating electricity so much as their performance in generating tax credits for wealthy individual investors. Many of these early turbines had to be replaced within a very short period of time due to poor performance. The result was a "black eye" for the wind industry that required more than a decade for it to live down. Ultimately, the government recognized the wisdom of restructuring its incentives to the wind industry as production tax credits rather than investment tax credits. This cautionary tale should clearly provide a warning that a hastily adopted solar program may actually set back the cause of solar power development if the program does not contain a well-conceived incentive structure.

Moreover, capacity-based incentives are simply not adequate to ensure that ratepayers are getting the program results they are paying for. As reflected in Itron's 4th Year Impact Report on the SGIP, the

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2 Revised Staff Proposal, p. 21.

weighted average annual capacity factor for solar PV projects was 16%.[3] The weighted average contribution to demand impact during the hour of the CAISO system peak demand in 2004 was 0.39 kW per 1.00 kW of solar system capacity based on rebated size.[4] The Impact Report also reflects that actual production from solar units participating in the SGIP program was highly variable. For example, the PV system that produced the highest output during each of the hours from 8 a.m. to 12 p.m. also had its production plummet 76% from just one hour to the next due to weather conditions.[5] The Impact Report also points to the problem of panel "soiling" as a factor that reduces the demand impact yielded by SGIP PV systems. Itron's research indicates that the size of the PV unit is simply not an accurate predictor of system output sufficient to assure ratepayers that they will receive an adequate return on their incentive investment.

The Revised Staff Proposal suggests a hybrid incentive structure be established by 2007, with 50% of the rebate paid up-front based on estimated performance and the remainder held back for five years.[6] This is an acceptable starting point, and one which should be adopted on an interim basis until the workshops contemplated in the Revised Staff Proposal are conducted.

2. The Commission Should Implement Strict Eligibility and Installation Standards.

In addition to performance-based incentives, the historical performance of solar PV projects under the SGIP suggests the need for strict eligibility and installation standards. The Revised Staff Proposal states that "performance of [new residential] systems would be ensured by adjusting the incentives paid to the specific insulation, shading, orientation, and installation characteristics of the systems."[7] However, there is no mention of eligibility and installation standards for commercial and residential retrofit projects, or any correlation between such standards and incentives paid to commercial and residential projects. SCE urges the Commission to adopt strict eligibility and installation standards as a prerequisite to program participation. Further, so long as the Commission proceeds with full or partial

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[3] Itron, Inc., CPUC Self Generation Incentive Program Fourth-Year Impact Report (April 15, 2005), p. 1-4, Table 1-2.

[4] *Id.*, p. 10-10.

[5] *Id.*, p. 8-6.

[6] Revised Staff Proposal, p. 19.

[7] *Id.*, p. 26.

capacity-based incentives for commercial and existing residential projects, such incentives should likewise be adjusted based on installation characteristics.

A system's output is greatly influenced by the specific photovoltaic module technology, orientation and tilt of the panels, local weather conditions, and maintenance practices. For example, as discussed above, "soiling" is one factor that explains the poor demand impact yielded by SGIP solar PV systems. PV studies typically estimate soiling losses to be in the range of five to ten percent of annual energy output, but may be much higher.[8] For these reasons, the Commission should implement strict eligibility requirements pertaining to the customer site where a solar system would be installed, including items such as the optimum orientation of panels, minimum annual level of available sunshine, no excessive shading, and maintenance obligations. Such requirements will result in the maximum benefit to both ratepayers and host customers. Further, the Commission should adjust incentive levels to correspond to the installation quality and verification of system performance, thereby ensuring the most productive and cost-effective installations.

3. **The CSI Must Provide for Mid-Term Assessments with Opportunities for Mid-Course Correction.**

As reflected above, initial reports on the performance of PV installations and the cost-effectiveness of solar PV SGIP projects raise serious concerns as to the cost of investing in PV to reduce peak demand. The Draft Decision acknowledges that solar technologies are not yet cost-effective, but nevertheless adopts the CSI with the goal of developing a competitive solar industry.[9] However, as the first Joint Staff Report[10] stated, "[a]fter eight years and close to $1 billion of subsidies, installed solar costs in California have decreased only slightly, and the industry has made little progress in reaching a self-sustaining market."[11] History thus suggests that the installed costs of solar power in California may

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[8] Itron, Inc., CPUC Self-Generation Incentive Program Fourth-Year Impact Report (April 15, 2005), Appendix A.

[9] Draft Decision, p. 9.

[10] ACR Seeking Comment on Staff Solar Report, Attachment 1 (CPUC and CEC Joint Staff Proposal to Implement a California Solar Initiative), June 14, 2005.

[11] *Id.* p. 4. Itron also notes the discrepancy between the reduction in PV system component costs and the lack of PV system price reductions during the first four years of the SGIP. Itron Report, p. 1-10.

not decline in response to an artificially-induced increase in demand for solar panels to the point that the industry could sustain itself without incentives.

Given the poor cost-effectiveness results of solar PV, the poor track record of price reductions, and the absence of a Commission strategy to achieve a competitive solar market, it is imperative that the Commission provide for mid-term assessments of the CSI with an express opportunity for program modifications, and, if justified, early termination. SCE recommends that the Commission review the progress of the program at years 2009 and 2012. Such mid-term assessments will afford the Commission and stakeholders the opportunity to reassess the efficacy of the program and terminate the program early should it become apparent that a competitive solar industry is not developing or installed solar systems are not performing as contemplated.

B. The Commission Should Work with the Legislature to Equitably Fund the CSI.

In contrast to SB 1, which would have required that both Investor-Owned Utilities (IOUs) and municipal utilities fund the Million Solar Roofs Initiative, the Draft Decision places the entire cost burden for the CSI program on IOU ratepayers. Reduction of greenhouse gas emissions is a statewide – even global – goal. To the extent that the policy basis for increasing funding for PV solar power is the perceived environmental benefits it provides, those benefits inure to all residents of the State and the cost associated with obtaining the benefits should not be borne exclusively by the distribution customers of IOUs.

It is worth noting that originally SB 1 had proposed a statewide funding level of $2.5 Billion, of which $1.8 Billion was to be borne by IOU ratepayers, with the remaining $700 Million funded by publicly-owned utility customers. In the absence of the passage of SB 1, the Commission proposes to implement the Governor's statewide "Million Solar Roofs Initiative" through the CSI, in a manner which augments overall program funding by $300 Million for 2006, and allocates all program costs exclusively to IOU ratepayers. This approach is inequitable. The Commission should not merely divine some desired statewide funding level and then place the financial burden entirely on IOU ratepayers. Rather, the Commission should seek an equitable funding level by determining the cost to ratepayers and the demonstrated benefits they receive and look to other statewide vehicles to help support the State's underlying environmental goals.

C. The Commission Should Postpone Committing to a Firm Long-Term Funding Level Until Key Issues are Addressed.

1. The Commission Should Complete its Cost-Benefit Work Before Adopting a Long-Term Funding Level.

For more than a year and a half, the Commission has been engaged in establishing a comprehensive cost-benefit methodology to assess distributed generation technologies and subsidy programs, and compare resource options. The Commission has already held hearings on this topic, and issued a Draft Decision which proposed to adopt a cost-benefit methodology. The Commission is on the cusp of putting in place the analytical tools necessary to discuss the appropriate levels and methods of funding for solar PV and other distributed generation technologies. Indeed, the first Staff Solar Report recognized the importance of this cost-benefit analysis, indicating that the cost-benefit methodology adopted by the Commission would be incorporated into the CSI program design.[12]

The Draft Decision does not even acknowledge the cost-benefit work that has been conducted in R.04-03-017, let alone incorporate a cost-benefit analysis into the CSI program design. Indeed, the Draft Decision acknowledges that solar PV projects are not cost-effective, but nevertheless directs an addition $2.5 Billion dollars in ratepayer funds to subsidize rooftop installations in an effort to support solar market development.[13] It is crucial that the Commission conduct a thorough inquiry into the costs and benefits of solar PV in general, and the CSI as proposed, because information to date indicates that PV solar projects installed under the Self Generation Incentive Program (SGIP) have not been cost-beneficial. According to a report issued by Itron, an independent consultant hired by the Commission, for every dollar per kW spent on PV solar SGIP projects, society receives a mere 27 cents in benefits. Despite

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12 ACR Seeking Comment on Staff Solar Report, Attachment 1 (CEC and CPUC Joint Staff Proposal to Implement a California Solar Initiative), June 14, 2005, p. 4 ("The agencies are in the midst of a proceeding to develop a common cost-benefit methodology for use in utility resource planning and procurement, and to determine incentives for procurement resources. This proceeding will help to quantify the costs and benefits of distributed solar energy systems in the state. As the costs and benefits of solar are quantified, we will incorporate the determined value in our CSI program design.")

13 As discussed further below, the Draft Decision states that the Commission does not have a strategy to achieve this goal, but intends to pursue one in the future.

these results, the Commission proposes to direct a significant sum of ratepayer monies to fund further solar PV rooftop installations.

Although the development of a competitive solar industry would be desirable on policy grounds, there is little or no evidence that there is a nexus between this long-term result and the adoption of the CSI at the proposed funding level. The Commission should not embark on a long-term and costly solar program without an informed and reasonable expectation that the program will result in net ratepayer benefits, or at least be the most cost-effective vehicle for achieving certain public policy objectives. This requires a full analysis of the rate impacts of the program and the measurable benefits received. Further, the Commission has a responsibility to examine whether incentives for solar rooftop installations represent the best use of limited ratepayer funds when compared to other resource options and applications, and when considered along side other stated Commission goals such as encouraging economic development and keeping rates affordable.

If, after such thoughtful analysis, the Commission determines that incentives for solar rooftop installations are the preferred vehicle for achieving certain public policy goals, the Commission must still examine ways to improve the cost-effectiveness of those installations. The Commission should, at a minimum, adopt performance-based incentives and strict eligibility and installation standards, and consider increasing ratepayer benefits by allowing the utilities to count the output from SGIP solar projects towards their renewable goals. Moreover, as reflected in the recent resource adequacy decision,[14] the extent to which the CSI leads to solar PV installations and a corresponding reduction in load should be reflected in load forecasts for purposes of resource adequacy.

2. The Commission Should Establish a Record Concerning Appropriate Funding and Rate Impacts.

Public Utilities Code section 1705 requires that Commission decisions contain findings of fact and conclusions of law on all issues material to the decision, including basic facts upon which the ultimate finding is based.[15] Here, the Draft Decision proposes to commit an additional $2.5 Billion in

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[14] Decision 05-10-042, p. 40.

[15] *See* Public Utilities Code § 1705; *Cal Motor Trans. Co. v. Pub. Utilities Com*., 59 Cal. 2d 270, 273-74 (1963).

ratepayer funds to the CERB component of the CSI without any findings supporting this funding level. Indeed, in Decision 05-12-044, which was issued roughly two weeks ago, the Commission deferred adoption of a long-term funding level because "neither the Staff Report nor the record in this proceeding analyze an appropriate level of CSI funding."[16] Nothing has changed in the last two weeks. The record has not been augmented to support a $2.5 Billion dollar increase in revenue requirement. In fact, as discussed below, there remain numerous outstanding questions which govern the appropriate level of CSI funding.

The Draft Decision also lacks any analysis concerning rate impacts. The Revised Staff Proposal claims that the proposed funding level will not result in rate increases for most customers because "the Rate Reduction Bonds authorized in AB 1890 are due to expire at the end of 2007, which will leave additional headroom in utility rates to allow the CSI to be funded without the need for substantial rate increases."[17] The Revised Staff Proposal goes on to estimate – without any analysis whatsoever – what the average rate impacts will be. Both the Staff's rationale and its estimates are flawed.

First, the Rate Reduction Bonds only apply to domestic and small commercial customers. Therefore, the Staff's theory is entirely inapplicable to rates paid by medium and large commercial customers, and agricultural customers. Moreover, the notion that the utilities have "headroom" in their rates to replace Rate Reduction Bond costs is shortsighted. This implies a policy of an upward one-way ratcheting of electric rates to fund statewide public purpose programs. Any reductions in rates following the collection of the excessive costs incurred during the energy crisis should not be routinely "filled in" by increases in public purpose programs which have not been thoroughly examined on their merits.

Furthermore, SCE cannot reconcile the estimated rate impact numbers presented in the Revised Staff Proposal. As reflected in Table 2, SCE's revenue requirement will be $119 Million per year in the early years of the program. However, according to SCE's analysis, the cents/kWh listed in Table 3 would only produce $7.23 million annually. Thus, it appears the Staff's analysis is off by a factor of more than 15. Moreover, the Staff's figure does not represent the full rate increase that SCE's ratepayers will

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16 D.05-12-044, p. 8.

17 Revised Staff Proposal, p. 12.

shoulder. The Commission must also consider other factors which result in cost-shifting to non-participating ratepayers, such as the contribution to margin that is lost when customers choose to self-generate, and the existing bill credits and exemptions non-participating customers subsidize. The Commission must complete a full and fair evaluation of the proposed program's impacts on ratepayers, including whether the increased costs to ratepayers are justified.[18]

3. The Commission Should Quickly Address the Unresolved Issues in the Revised Staff Proposal.

The Draft Decision proposes to commit $2.5 Billion in ratepayer funds before significant and numerous issues concerning program design are resolved. For instance, the Draft Decision acknowledges that "federal tax credits may affect solar energy investments that may obviate the need for a full CSI rebate for some projects" and proposes to augment the record to provide information about the likely impact of federal tax credits on decisions to invest in solar projects.[19] Similarly, the Draft Decision acknowledges that "performance-based incentives may motivate better investments in and maintenance of solar projects than capacity-based incentives," and that the record should be developed to design a performance-based incentive program.[20] The Draft Decision further acknowledges that "additional metering requirements for solar installations may permit rate design that improves cost-effectiveness and appropriately recognizes the value of solar electricity production," but that the record in this proceeding does not permit the adoption of additional metering requirements at this time.[21] The Draft Decision also acknowledges that "some projects may need smaller rebates or none at all if they are provided with financing at low cost or no cost," but that the record in this proceeding does not provide information on financing needs or design.[22]

Elements such as incentive design, rate design, financing, and the impact of federal tax incentives will themselves govern the necessary level of CSI funding. A program utilizing performance-based

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[18] *See, e.g.*, Public Utilities Code §§ 451 and 454 which provide that rates charged by utilities must be just and reasonable, and no utility may change a rate without a Commission finding that the new rate is justified.

[19] Draft Decision, Finding of Fact 7.

[20] *Id.*, Finding of Fact 9.

[21] *Id.*, Finding of Fact 18.

[22] *Id.*, Finding of Fact 14.

incentives may require different funding than a capacity-based incentive program. Similarly, if low-cost financing will eliminate the need for incentives, program funding will be affected accordingly. If additional metering and rate design can be utilized to increase the cost-effectiveness of the program, funding levels should be adjusted. The point is, each of the outstanding issues mentioned in the Draft Decision and Revised Staff Proposal will govern the overall program design and necessary funding. The Draft Decision nevertheless proposes to commit now to a long-term funding plan *before* addressing these issues.

Perhaps even more disconcerting is the admitted absence of any plan or strategy for achieving the stated goal of the CSI – a cost-competitive solar industry. The Draft Decision states:

> Many of the parties to this proceeding observe that solar technologies are not yet cost-effective. We share this concern and adopt the CSI with the objective of supporting the development of an industry that can compete with more conventional technologies and that is robust without government subsidies. ***We have not addressed here a specific strategy to effect that objective but intend to pursue it in the near future***.[23]

SCE respectfully suggests that the Commission should have a well-conceived plan with a reasonable prospect for achieving its goal *before* collecting and spending $2.5 Billion in ratepayer funds.

The Commission is responsible for designing and funding the CSI in such a way as to ensure the best and most cost-effective use of ratepayer funds. There can be no dispute that the outstanding issues mentioned in the Draft Decision bear directly on the cost-effectiveness of the CSI, the appropriate level of funding, and the overall probability of program success. The Commission should thus address these issues *before* committing additional and significant ratepayer funds to the CSI. Once these matters are addressed, the Commission can make an informed decision regarding total funding levels.

III. CONCLUSION

For the foregoing reasons, SCE respectfully requests that the Commission take a number of steps to enhance the chances for ratepayer benefit and program success. The Commission should:

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[23] *Id*., p. 9 (emphasis added).

- Structure the CSI around performance-based incentives, and adopt an interim performance-based incentive framework with 50% of the rebate paid up-front based on estimated performance and the remainder held back for five years;
- Require strict eligibility and installation standards;
- Institute mid-term assessments of the program with the opportunity for program modification;
- Work with the Legislature to establish a more equitable funding source; and
- Postpone adopting a firm long-term funding level until cost-benefit analysis is completed and key program design elements are addressed.

Respectfully submitted,

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January 3, 2006

CERTIFICATE OF SERVICE

I hereby certify that, pursuant to the Commission's Rules of Practice and Procedure, I have this day served a true copy of SOUTHERN CALIFORNIA EDISON COMPANY'S (U 338-E) COMMENTS ON INTERIM ORDER ADOPTING POLICIES AND FUNDING FOR THE CALIFORNIA SOLAR INITIATIVE on all parties identified on the attached service list(s). Service was effected by one or more means indicated below:

☑ Transmitting the copies via e-mail to all parties who have provided an e-mail address. First class mail will be used if electronic service cannot be effectuated.

☑ Placing the copies in sealed envelopes and causing such envelopes to be delivered by hand or by overnight courier to the offices of the Commission or other addressee(s).

☐ Placing copies in properly addressed sealed envelopes and depositing such copies in the United States mail with first-class postage prepaid to all parties.

☐ Directing Prographics to place the copies in properly addressed sealed envelopes and to deposit such envelopes in the United States mail with first-class postage prepaid to all parties.

Executed this **3rd day of January, 2006**, at Rosemead, California.

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