

June 25, 2004

Administrative Law Judge Jeffrey P. O'Donnell  
California Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, CA 94102

Re: *Application No. 04-02-026 ("Application")*

Dear Judge O'Donnell:

This is to inform you that the contractual dispute among the co-owners of San Onofre Nuclear Generating Station ("SONGS") Units 2 & 3 over whether steam generator degradation at SONGS Units 2 & 3 represents an Operating Impairment, as that term is defined in the Second Amended San Onofre Operating Agreement ("Operating Agreement"), has been resolved. SCE has advised its co-owners that an Operating Impairment exists at SONGS Units 2 & 3, consisting of the circumstances described in the Application. SDG&E has voluntarily dismissed its complaint filed in Superior Court seeking declaration of an Operating Impairment.

This action by SCE eliminates the requirement under the Operating Agreement that all of the owners approve steam generator replacement in order for it to proceed. Each of the other owners now has a right under the Operating Agreement to elect to have its ownership share in SONGS Units 2 & 3 reduced in lieu of participation in steam generator replacement. The election must be made by October 19, 2004.<sup>1</sup>

If an owner elects to opt out of participation in steam generator replacement and the project proceeds without its participation, the amount of the ownership share reduction will be determined based on the cost of the project and the value of capacity in each Unit to SCE and the other owner. If the parties are unable to agree on the capacity values, the Operating Agreement provides that the dispute may be submitted to arbitration. The Operating Agreement also provides that the capacity values of SCE and SDG&E will be subject to regulatory approval.

At the Pre-Hearing Conference on May 18, 2004, SDG&E's counsel informed you that "if an Operating Impairment is declared, San Diego is willing to litigate the question of the ownership share reduction before the Commission and not take that proceeding to arbitration in order to have as prompt a resolution of that as possible."

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<sup>1</sup> SCE also has the right under the Operating Agreement to decline to proceed with steam generator replacement. SCE would exercise this right if it did not receive sufficient Commission approval. In that case, the owners would proceed to decommission and retire the Units.

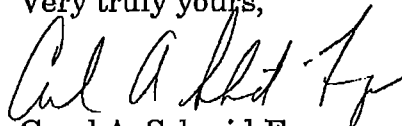
(Pre-Hearing Conference transcript, at 106, ll. 14-19.) SCE agrees with SDG&E's proposal to have the Commission resolve the dispute over the capacity values in this docket, if SCE and SDG&E cannot agree on capacity values.

The declaration of an Operating Impairment does not affect SCE's request for interim approval in September 2004. Nor should it affect the schedule established at the May 18, 2004 Pre-Hearing Conference. SCE has already submitted augmented testimony (SCE-9) addressing the cost-effectiveness of the steam generator replacement project assuming the full range of possible reductions in the ownership shares of the other owners. SCE has also already submitted its computation of its capacity value in its augmented testimony. By July 16, 2004, SCE will submit an amended application and testimony to reflect the existence of an Operating Impairment and the effects of a possible increase in SCE's ownership share, including proposed ratemaking for any additional ownership share and other terms and conditions of an ownership share transfer.

The declaration of an Operating Impairment will eliminate some objections to the Application. In particular, at the Pre-Hearing Conference on May 18, 2004, SDG&E's counsel informed you that it would withdraw its protest to SCE's application if SCE declared an Operating Impairment. (Pre-Hearing Conference transcript, at 106, ll. 12-14.)

If SDG&E elects to exercise its contractual right to have its ownership share reduced in lieu of participation in steam generator replacement, the resulting transfer of all or a portion of SDG&E's ownership share will be subject to Commission approval. SCE continues to believe that SDG&E's continued ownership of SONGS Units 2 & 3 and participation in steam generator replacement is in the best interests of all ratepayers. Thus, SCE may oppose the transfer before the Commission.

Very truly yours,



Carol A. Schmid-Frazee

cc: All Parties of Record in A.04-02-026  
J. Avery/SDG&E  
T.P. Evans/City of Riverside  
S. Sciortino/City of Anaheim  
J. Walsh/SDG&E  
L. Moses/City of Anaheim  
E. Teichert/City of Riverside