DRAFT TALKING POINTS FOR 9/10/04 MEETING WITH CPUC PRESIDENT PEEVY

SDG&E'S ECONOMICS

- SCE estimates that their Steam Generator Replacement Project (SGRP) will cost approximately $782 million. SDG&E's share would be $163 million.

- SDG&E evaluated the economic impact of SGRP to its customers, by comparing three alternatives:
  - Participate in the SGRP
  - Do not perform the SGRP (assumed SONGS would shut down in 2009-10)
  - Do not participate in the SGRP

- Not participating in SGRP is the most economical alternative for SDG&E customers because the $163 million savings outweighs the cost to replace SDG&E's reduced SONGS ownership.

- The ownership reduction will not impact the reliability of supply to SDG&E's customers because any reduction in SONGS capacity can easily be replaced from the market.

OPERATING IMPAIRMENT

- Under the terms of the SONGS Operating Agreement an "Operating Impairment" (OI) is any unplanned event which may reduce the plant's capacity or reliability

- SONGS co-owners have a contractual right to choose whether to participate in projects that are necessary to restore an OI.

- From the beginning SDG&E believed steam generator problem was clearly an OI, as that term is defined in the Operating Agreement.

- SCE originally refused to declare an OI, so SDG&E filed a complaint in San Diego Superior Court asking for a declaration that the deterioration of SONGS steam generators is an OI under the terms of the Operating Agreement.

- In June SCE declared an OI and SDG&E dismissed its complaint.

- That declaration gave SDG&E a choice of whether to participate in the SGRP, and SDG&E elected not to participate.

SDG&E'S OWNERSHIP REDUCTION

- As a result of not participating in the SGRP, SDG&E's ownership of SONGS will be reduced in 2010 when the SGRP is completed. SCE's ownership of SONGS will be increased by the same amount.

- The amount of the reduction is to be determined by a formula contained in the SONGS Operating Agreement, which can be interpreted with widely differing results.

- By SDG&E's interpretation, our ownership will be reduced from the current 20% to 10-15%. SCE's interpretation would result in SDG&E's ownership going to zero.

- The Operating Agreement calls for this disagreement to be resolved by arbitration. That arbitration will begin soon.

- The outcome of the arbitration will be submitted to the CPUC for approval because the CPUC has final authority on any change in SONGS ownership by SCE or SDG&E.

- SDG&E has not yet fully developed its litigation position other than to say in our protest that using SCE's filing information our share would not fall below 12.6% and could be higher.

- We are working now on a actual litigation position respecting our ownership reduction. Sargent & Lundy is assisting us in that effort.

- SDG&E will file testimony in December in SCE's SGRP stating why it is not in the best interest of our customers to participate in SGRP, and what our resulting ownership reduction should be.

DETAILS REGARDING Ve AND Vop

- The formula for determining SDG&E's ownership reduction is:

$$\text{Ownership reduction (kW)} = \frac{\text{Avoided cost (SDG\&E's share of SGRP cost)}}{\text{Value of SONGS capacity (\$/kW) *}}$$

* Value of SONGS capacity is the average of "Ve" (the value to Edison) and "Vop" (the value to the other party - SDG&E).

economic attributes & output (low energy cost) vs value of the unit.

- Definition of Ve: **"The value to Edison at that time, expressed in dollars per kilowatt, of capacity in such Unit over its remaining lifetime, considering Edison's need for capacity and the alternatives available to Edison at that time."** [Presumably "at that time" means 2010, and "remaining lifetime" means 2010-2022.]

- Definition of Vop: **"The value to such Other Party at that time, expressed in dollars per kilowatt, of capacity in such Unit over its remaining lifetime, considering such Other Party's need for capacity and the alternatives available to such Other Party at that time; provided, however, for purposes of this formula, Vop shall not be greater than Ve."** [Due to this limitation, Ve is the controlling factor in determining ownership reduction.]

- SCE has estimated Ve to be $215/kW, based on the value of deferring installation of replacement capacity (Combustion Turbine Peakers) from 2010 to 2022. If that is approved, SDG&E's ownership will be reduced to 0%.

- SCE's method for estimating Ve is inappropriate and incorrect for several reasons:
  - Ve and Vop is essentially the price being used to transfer a portion of SONGS (the asset) from one owner to another. Therefore Ve and Vop should reflect the value of that asset rather than the price of electricity (i.e., energy price + capacity price).
  - The use of CT peakers for large capacity increments would create a system imbalance that would no longer be a least-cost mix of generation.
  - CT peakers are most suitable for marginal capacity increments. This is not the case with SONGS.
  - SCE cites 1982 CPUC documents that determine capacity payments to QFs "to meet reliability needs alone". This is not the same as determining the value of a specific asset, and SONGS provides low cost energy at a desirable location in addition to reliability.
  - The Operating Agreement suggests that replacement capacity should take into account SONGS operating cost attributes and location.

- SCE's SGRP filing indicates a Combined Cycle plant would be the logical replacement for SONGS.
- SCE makes a mathematical error by discounting Ve to 2004$.
- SCE's Vop ($215/kW) is unreasonable compared to the cost of SGRP ($316/kW), and even more so compared to SCE's projected net present value of SGRP ($708/kW to $848/kW).

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