SOUTHERN CALIFORNIA
EDISON
An EDISON INTERNATIONAL Company

Harold B. Ray
Executive Vice President

June 3, 1996

Mr. William T. Russell, Director
Office of Nuclear Reactor Regulation
U.S. Nuclear Regulatory Commission
Washington, DC 20055-0001

Dear Mr. Russell:

Subject: **Docket Nos. 50-361 and 50-362**
Restructuring Issues
San Onofre Nuclear Generating Station
Units 2 and 3

Southern California Edison Company (Edison) is pleased to respond to your letter of April 4, 1996 requesting information about any pending or planned actions that may include significant divestiture of assets, formation of a new company, and other initiatives that may change Edison's status as an "electric utility" or otherwise alter the basis under which Edison received its operating licenses for the San Onofre units (SONGS).

As you are aware, Edison intends to take actions shortly with respect to restructuring and deregulation that may include a divestiture of certain assets, but these changes will neither change Edison's status as an "electric utility" nor will they alter the financial qualification basis under which Edison received its operating licenses for the SONGS units. With respect to the potential for any changes to the technical basis for the SONGS license issuance as a result of the restructuring action of creating an Independent System Operator (ISO), Edison is currently reviewing this issue and will inform the NRC of any necessary changes. Your letter states that asset divestiture, in and of itself, is not of significant concern to the NRC as long as a licensee retains a substantial asset base or retains access to adequate regulated rate recovery, particularly with respect to assuring that adequate decommissioning funds will be available. These implicit tests of a substantial asset base or access to adequate regulated rate recovery are not found in NRC's applicable regulations, and they are not determinative of whether Edison's proposed actions will alter the basis under which SONGS received its operating licenses. In 1982, when the NRC issued the operating licenses for the SONGS units, the relevant regulatory requirement for a showing of financial qualifications was 10 C.F.R. 50.33(f)

> If the application is for an operating license, such information shall show that the applicant possesses or has reasonable assurance of obtaining the funds necessary to cover the estimated costs of operation for the period of the license or for 5 years, whichever is

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greater, plus the estimated costs of permanently shutting the facility down and maintaining it in a safe condition.

NRC guidance in 10 C.F.R. Part 50 Appendix C for making this showing indicates that a demonstration of "resources sufficient to cover estimated operating costs for each of the first 5 years of operation plus the estimated costs of permanent shutdown and maintenance of the facility in safe condition" is ordinarily sufficient.

In accordance with these requirements, the NRC concluded in its Safety Evaluation Report (SER) for the SONGS operating licenses that the applicants (including Edison) "have satisfied the reasonable assurance standard and are therefore financially qualified to operate and, if necessary, shutdown and safely maintain" SONGS. The NRC's stated basis for its conclusion was "the applicants' demonstrated ability to achieve revenues sufficient to cover all operating costs and interest charges, their status as electric utilities, and the size of their operations."

The NRC did not define the term "electric utility" in the basis for its conclusion in the SER. The only reference in the SER to the applicants' status as electric utilities refers to their "having exclusive service to their respective territories," but this language seems to be merely descriptive of their current status rather than essential to the definition of the term "electric utility." Significantly, at the time the SONGS SER and operating licenses were issued, the NRC had published proposed amendments to the financial qualifications regulations that would define for the first time the term "electric utility" in Title 10 of the Code of Federal Regulations. This definition, which is identical to the definition now in the regulations, does not rely in any way on a finding that the applicant/licensee provides exclusive service to designated territories.

Although the NRC stated in the SONGS SER that one of the bases for its conclusion on financial qualifications was "the size of their operations," it did not provide any indication in the record that any asset test was applicable to this finding other than that found in 10 C.F.R. 50.33(f) and 10 C.F.R. Part 50 Appendix C, as described above. The regulatory test is one of either assets or revenues or both as described in 10 C.F.R. Part 50 Appendix C. "Section 50.33(f) requires that all applications for operating licenses show that the applicant possesses the funds necessary to cover estimated operating costs, or has reasonable assurance of obtaining the necessary funds, or a combination of the two." Under this regulatory test, the basis under which Edison received its SONGS operating licenses is not altered unless the combination of assets and revenues is reduced to a level that is insufficient to cover estimated operating costs for five years plus the estimated costs of permanent shutdown and decommissioning. This is consistent with the NRC Staff's current view of the issue of asset divestiture in the context of financial qualifications, as reflected in the statement in your letter that "asset divestiture, in and of itself, is not of significant concern to the NRC as long as a licensee retains a substantial asset base or retains access to adequate regulated rate recovery, particularly with respect to assuring that adequate decommissioning funds will be available."

With our letter of May 3, we sent the Commission a copy of Edison's plan for the voluntary divestiture of certain fossil generating assets that was submitted to the California Public Utilities Commission ("CPUC") on March 19, 1996, in the CPUC's restructuring proceeding. That plan

provides for Edison to conduct an auction for fifty percent of its fossil generation located in the Los Angeles basin as a prophylactic measure to address possible market power concerns in a retail customer choice environment. The divestiture plan does not identify specific facilities to be sold, and the precise timing of any divestiture is presently uncertain. The plan is subject to review and approval by the CPUC, and aspects of the proposal may be changed.

I would emphasize that, even with the divestiture of fossil generation in accordance with Edison's voluntary plan, Edison will retain a substantial non-nuclear asset base which exceeds that of most nuclear plant licensees. This includes Edison's extensive transmission and distribution system.

The CPUC's restructuring order does not require Edison to create separate corporate entities to own generation, transmission, and distribution assets, but instead calls for "functional unbundling" within the existing corporate structure. Accordingly, no current regulatory requirements exist for Edison to engage in further corporate restructuring that would separate the ownership of San Onofre from other assets. However, the CPUC's restructuring order contemplates a phased movement to a broadly competitive electricity market. As this process goes forward, Edison will be continuously evaluating whether additional changes in its corporate or asset structure are appropriate. In this regard, the CPUC order provides for each of Edison's fossil generating facilities to go through a "market valuation" process by 2003 for the purpose of calculating the amount of transition costs Edison may recover by a non-bypassable competition transition charge ("CTC") to be imposed on all retail consumers in Edison's service territory. Under the order, the market valuation of each of these assets may be established by independent appraisal, by the price obtained by the sale of the asset, or by the value of the securities of a new entity created by a "spin-off" of the asset.

The CPUC order does not require Edison to subject its hydroelectric generating resources to this market valuation. Rather, the order provides that Edison will retain these generation assets and sell their output at market rates after 1998, with the surplus revenue over these assets' regulated revenue requirements reducing Edison's transition costs. The CPUC stated that it may consider the sale or spin-off of such assets in the future, in which case the resulting gain again would reduce Edison's transition costs.

Your letter states that the NRC requires that its licensees inform and obtain advance approval from the NRC of <u>any</u> changes that would constitute a direct or indirect transfer of control of the NRC license pursuant to Section 50.80. You state that these changes would also be subject to NRC license amendment approval procedures pursuant to 10 C.F.R. 50.90. As described above, the proposed actions that Edison plans to take with respect to some of its generating assets constitute merely a divestiture of certain non-nuclear assets. Edison will continue as the licensee and there will be no direct or indirect transfer of control of the license. There is nothing in the history of 10 C.F.R. 50.80 that indicates that any action other than such an actual transfer of control of the license will trigger applicability of the regulation. Therefore, the provisions of 10 C.F.R. 50.80 that require NRC written consent to any direct or indirect transfer of control will not apply to Edison's actions. Furthermore, there is no need for a license amendment because the licensee and operator of SONGS (Edison) remains unchanged.

The electricity industry reforms initiated by the CPUC entail the replacement of traditional rate regulation with market competition for many electric utility services in California. Under the CPUC-approved rate plan for SONGS 2 and 3, Edison will obtain accelerated recovery of its sunk investment costs in SONGS 2 and 3 over eight years (1996-2003). In addition, Edison will recover its SONGS 2 and 3 operating and incremental capital costs over the eight-year transition period through a pre-set price (averaging four cents) for each kilowatt-hour of energy produced by these units. Following this eight-year transition period, SONGS 2 and 3 generation will be sold in the open market. Fifty percent of the post-2003 benefits of SONGS 2 and 3 operation will be allocated to consumers through: (1) an audit of the net operating profits, (2) a determination of the gain on sale, (3) an independent appraisal, or (4) some other method. The CPUC will approve the allocation method upon consideration of an application to be filed by Edison by July 1, 2002. The restructuring order and the SONGS 2 and 3 rate plan will enable Edison to meet its health and safety responsibilities under its nuclear licenses in the context of a restructured electric industry.

Furthermore, the CPUC restructuring orders and the SONGS 2 and 3 rate plan retain full cost-of-service rate recovery of decommissioning costs. In its restructuring order, the CPUC made clear that nuclear decommissioning costs "require special consideration," and that it "will ensure that adequate funds continue to be collected to cover the costs of nuclear decommissioning," and "will continue to oversee and monitor the existing trust funds to ensure that they are adequately maintained." Therefore, insofar as the recovery of decommissioning costs is concerned, the California restructuring proposal does not make any fundamental change to the traditional regulatory framework.

The CPUC has ordered Edison to file a rate plan for its share of the Palo Verde Nuclear Station that is based on the same principles as the SONGS 2 and 3 plan. Accordingly, Edison believes that state regulation continues to provide the necessary assurance that Edison will recover the costs to safely operate and decommission the nuclear facilities in which it has an ownership interest. After 2003, Edison will have to recover its incremental costs in the marketplace, but will have recovered its sunk investment in its nuclear plants by that time and will have regulatory assurance of the availability of funds for decommissioning. Accordingly, if the electricity market does not support continued nuclear plant operation after 2003, Edison will be able to shut down its plants and provide for post-shutdown activities in accordance with NRC health and safety requirements.

During plant operation, NRC's existing inspection processes are the primary basis for assessing performance and compliance with health and safety requirements. Given the absence of any demonstrable correlation between funding levels and safety performance across the nuclear industry, there is no financial index that could be used in a compliance-based test to provide advance notice of a future decline in safety performance. However, any decline in performance due to potential reductions in funding would be apparent through the NRC's inspection process long before operations could reach an unsafe condition. Therefore, the transition to marketplace recovery of incremental costs should not change the effectiveness of the NRC's existing inspection and enforcement processes in providing adequate assurance of protection of public health and safety during the operation of SONGS 2 and 3.

Your letter requests that Edison submit information relevant to recent or impending changes to Edison's corporate structure, with a particular emphasis on "newly formed entities." Under 10 C.F.R. 50.33(f)(3) "a newly formed entity organized for the primary purpose of constructing or operating a facility" is subject to additional requirements for a showing of financial qualifications. Guidance for compliance with these requirements is found in 10 C.F.R. Part 50 Appendix C. Edison has not created any "newly formed entity" organized for the primary purpose of constructing or operating a production or utilization facility within the meaning of 10 C.F.R. 50.33(f)(3), nor does it propose to create any such "newly formed entity" in the near future.

Edison will remain an "electric utility" as defined in 10 C.F.R. § 50.2, as an "entity that generates or distributes electricity and which recovers the cost of this electricity, either directly or indirectly, through rates established by the entity itself or by a separate regulatory authority." As noted above, the CPUC's orders provide that, for the foreseeable future, Edison will remain a public utility whose generation and distribution assets are dedicated to public use and are subject to rate regulation by the CPUC. Under the CPUC's orders, Edison will sell its fossil generation output at market rates after 1998 and its nuclear generation output at market rates after 2003, although certain "regulatory must-run" generating units remain subject to CPUC regulation. Moreover, the CPUC's orders also provide for Edison to recover its sunk capital costs in these generation assets by the CTC through 2005, and its SONGS 2 and 3 operating and incremental capital costs by regulated rates through 2003. Moreover, the CPUC will continue to regulate Edison's collection of funds for nuclear decommissioning.

A bill pending before the California legislature, which would require the CPUC to implement most of the provisions of its restructuring order, also would exempt from status as a state-regulated "public utility" an entity that simply sells generation services directly to end-users or through the "Power Exchange" envisioned by the CPUC restructuring decision. But under this bill, entities such as Edison that own transmission or distribution assets would remain regulated public utilities subject to state regulation.

Edison's long-range plans for responding to the restructuring of the industry through reorganization are necessarily less certain and much less specific than are its short-range plans. Restructuring will likely result in a series of changes that involve disaggregation of utility functions into separate businesses, some of which may remain within the regulated utility and some of which may not. These changes will also likely involve a transition from rate-based recovery of the cost of service to a market price system. However, at this time, predictions about the long-term results of industry restructuring and what Edison's future strategic plans may be are highly speculative and subject to change.

In our prior letter of May 3, 1996, we provided you a copy of "Comments of Southern California Edison Company (U338-E) on Plan for Voluntary Divestiture Submitted in Response to the Commission's December 20, 1995 Policy Decision" dated March 19, 1996 for your information. As we have indicated, Edison does not now have any specific plans to take any actions requiring NRC consent. Should Edison's plans change or develop in a manner which would modify any of the foregoing and thereby require NRC consent, such action would not be taken

without providing the NRC a reasonable period of time for review in accordance with applicable NRC regulations.

Your letter also poses a series of specific questions. Responses to each of the specific questions in your letter about recent or impending changes to Edison's corporate structure are found in the enclosure to this letter.

As I have previously indicated, we believe it essential that NRC continue to recognize the trend toward restructuring and deregulation in the electric industry and establish sound generic regulatory requirements and guidance on financial qualifications for entities undergoing restructuring and deregulation. We will continue to participate actively in NRC's efforts to establish such requirements and guidance and will be pleased to provide you with any information that may assist those efforts. Please feel free to call me with any questions about the information in this letter.

Sincerely,

Harold B. Ray

Enclosure

cc: Document Control Desk
L. J. Callan, Regional Administrator, NRC Region IV
J. E. Dyer, Director, Division of Reactor Projects, Region IV
K. E. Perkins, Jr., Director, Walnut Creek Field Office, NRC Region IV
J. A. Sloan, NRC Senior Resident Inspector, San Onofre Units 2 & 3
M. B. Fields, NRC Project Manager, San Onofre Units 2 and 3

Enclosure

RESPONSES TO SPECIFIC QUESTIONS IN NRC'S LETTER OF APRIL 4, 1996

1. Has SCE created any "newly-formed entities?"

   No. Edison has not created any "newly-formed entity" organized for the primary purpose of constructing or operating a production or utilization facility within the meaning of 10 C.F.R. 50.33(f)(3).

2. Does it propose to create any "newly-formed entities" in the near future?

   No. Edison does not plan to create any "newly formed entity" organized for the primary purpose of constructing or operating a production or utilization facility within the meaning of 10 C.F.R. 50.33(f)(3).

3. What types of "newly-formed entity" or entities have been or will be created?

   Not applicable. See responses to 1 and 2 above.

4. Will the creation of any "newly-formed entities" result in the direct or indirect transfer of control of the licenses for the San Onofre units?

   No. See responses to 1 and 2 above. The actions that Edison plans to take will not involve any change in the ownership of SONGS or in the identity of the facility licensee. Therefore, there will be no direct or indirect transfer of control of the SONGS operating licenses.

5. Will any "newly-formed entity" be an "electric utility" as defined by the NRC in 10 C.F.R. 50.2, and will it remain as such?

   Not applicable. Edison does not plan to create any "newly formed entity" organized for the primary purpose of constructing or operating a production or utilization facility within the meaning of 10 C.F.R. 50.33(f)(3).

6. Will SCE remain an "electric utility" under 10 C.F.R. 50.2?

   Yes. See the body of the letter for discussion of this issue.

7. Has SCE prepared and submitted information required by the U.S. Securities and Exchange Commission relating to the creation of any "newly-formed entity?"

No. Edison has not prepared and submitted any information to the U.S. Securities and Exchange Commission relating to the creation of any "newly-formed entity," organized for the primary purpose of constructing or operating a production or utilization facility within the meaning of 10 C.F.R. 50.33(f)(3).