STANDARD & POOR'S

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Southern California Edison

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Southern California Edison

Major Rating Factors

Corporate Credit Rating
BBB+/Stable/A-2

Strengths:

- Supportive regulatory mechanisms established by the California Public Utilities Commission (CPUC) allow utility Southern California Edison (SCE) timely and certain recovery of costs. Federal Energy Regulatory Commission (FERC) rulings continue to sustain stable returns on the utility's transmission investments.
- Low gas prices have kept retail electric rates flat for customers over the past two years, allowing the utility to carry out its capital program and contract for renewables generation without pressuring rates.
- Decoupling has shielded SCE from the direct effects of a deep state recession. A prolonged weak state economy could politically complicate SCE's efforts to pass through retail rate increases that will be needed in coming years.
- The extension of bonus depreciation boosted cash flows stemming from deferred taxes by nearly $1 billion in 2010, staving off borrowing requirements.
- The delay to 2013 of California's carbon cap-and-trade market will provide more time to address market design issues; Standard & Poor's Ratings Services expects electric utilities to be large participants in this market, and we believe it is important that the new market function as expected.

Weaknesses:

- SCE's sister subsidiary, Edison Mission Energy (EME; B-/Negative), faces refinancing risk in the next year and its liquidity is less than adequate. Although under our regulatory insulation criteria, utility ratings are above those on the parent and EME, the SCE ratings would fall if EIX were to support EME. EIX management has made no pledge to support EME, and has no contractual obligations to do so.
- SCE's 2011-2015 capital program has grown and is now forecast to be more than $1 billion higher than last year's five-year plan. This level of spending is unprecedented in the company's history. Due to multiple cost pressures, SCE retail electric rates will climb in years to come, especially if all of SCE's spending is approved in its pending rate case.
- Both the utility's adjusted and reported leverage is expected to increase as a function of capital investment and by 2013 could meet or exceed our stated limit of 60% debt to total capitalization on a fully adjusted basis. This compares to 2010 fully adjusted leverage of 56%.
- California's energy policies, which include a goal of 33% renewables by 2020 and a carbon cap-and-trade market in 2013, are aggressive.
- If pursued by SCE, the regulatory and political reaction to the Fukushima Daiichi nuclear disaster could complicate the relicensing of the San Onofre Nuclear Generating Station (SONGS), of which SCE is 78% owner and operator. A voter referendum that is collecting signatures for placement on the November ballot could close California's nuclear facilities if it were to qualify for the ballot and carry a majority. SONGS accounts for about 20% of SCE's total energy requirements.

Rationale

The 'BBB+' corporate credit rating (CCR) for Rosemead, Calif.-based utility company Southern California Edison (SCE) reflects an excellent business profile, as evidenced by a solid regulatory paradigm, a strong and diverse service territory that is predominantly composed of residential and small commercial customers, and management's ability to navigate the various risks of operating in a high-cost, dynamic state that is aggressively implementing energy policies to reduce carbon emissions and add renewable generation. SCE's significant financial profile reflects its balanced capital structure, which on a stand-alone basis reflects modest use of leverage. At year-end 2010, the utility's reported debt to total capitalization was a strong 45% (including short-term debt balances). Due to significant off-balance-sheet adjustments, particularly debt equivalents for power purchases, adjusted debt to capitalization is higher -- 56% at year-end 2010.

Standard & Poor's Ratings Services continues to view SCE's business profile as excellent, but we see it trending toward the weaker end of this category. We view the business profile as under pressure due to the level of retail rate increases that will be necessitated if the company carries out its forecast capital plan. SCE spent $3.78 billion on capital investments in 2010, up from average spending of $2.3 billion a year over the period of 2005 to 2009. Over the next five years (2011 to 2015), the company is proposing to spend $19.2 billion to $21.4 billion in capital, or about $3.9 billion to $4.3 billion per year. The lower end of the company's range has increased $1.2 billion from its five-year projections provided last year.

This shift, although not a direct negative for credit quality, is striking because it suggests that high capital investment may be a quasi-permanent feature of the California utility landscape. All U.S. electric utilities experience cyclical capital requirements, but high points in the cycle are typically short-lived (e.g., one to three years) unless a major nuclear or coal base load addition is planned. In contrast, the continuous addition of new energy policy objectives in California, coupled with SCE's more traditional need to replace aging infrastructure, is resulting in a ramp-up in capital investment that appears to have no clear end in sight.

SCE's next five years of proposed spending is composed of distribution investments needed to support reliability and large transmission infrastructure projects being built to foster solar and wind generation. These investments constitute 54% and 28%, respectively, of the forecast capital plan. Some of this investment reflects programs that the California Public Utilities Commission (CPUC) has already approved. For example, the CPUC has authorized installation of advanced meters in every home and business served by an investor-owned utility in the state over the next few years. SCE has also received approval to build as much as 250 megawatts of utility-owned, small-scale solar projects.

Not all proposed, incremental projects will necessarily be authorized, and much of the company's spending will depend on the outcome of the company's general rate case (GRC) pending before the California Public Utilities Commission (CPUC) for 2012 through 2014. (We expect a decision in that case in late 2011 or early 2012.) About half of the company's total revenue requirement is determined in its GRC.

High capital expenditures will have long-term implications for electric rates, and are not the only source of rate pressure. The state is pursuing numerous environmental goals that include a 33% renewable portfolio standard and a state carbon cap-and-trade market expected to start in 2013.

To date, rate pressure has not been a credit issue, due in large part to a hiatus in natural gas prices that has lowered fuel costs and allowed SCE to add to the rate base while holding down rates and customer bills. System average rates have been approximately flat at 14.3 cents per kilowatt-hour since 2009. But we now expect rates to begin rising. SCE's GRC request alone would increase system average rates more than 7% in 2012. SCE is also seeing an uptick in its fuel and purchased power costs, which are determined in a separate proceeding but which will add to the overall revenue requirement. And continued investment in transmission, largely needed to support renewables projects, will also require regular rate increases before the FERC.

Against these rate pressures, economic conditions in the state are anemic. Unemployment has remained in the area of 12% since September 2009 and was 11.8% based on preliminary estimates for June, a slight increase from May. Growth has not returned to the state, and personal income has not recovered from the depth of the recession. State deficits have strained services and led to austerity measures. At the same time, energy policy has been tone deaf to the diminished economic circumstances of many Californians, implicitly presuming that utility customers will be eager to trade higher rates for a transformed electric utility system. Due to a temperate climate, California bills are generally lower than the national average due to lower usage, retail electric rates are already among the highest in the nation.

Increasing utility bills present indirect and somewhat amorphous risks to credit quality because, when confronted with higher costs, utility customers have few choices other than to consume less. Nevertheless, there is a potential for ratepayer pushback, increased efforts to exit the system either through distributed generation or other forms of bypass, and the possibility that the CPUC will face more political pressure to curb the utility's future cost recovery if, in retrospect, spending seems excessive. But we note that there is little opportunity or precedent in the state to retroactively disallow spending, given forward test year ratemaking and electric utilities' ability to have projects approved in advance.

Although SCE could defer some capital investment as a way to manage rate increases coming from other cost pressures, we see it as having limited incentives to do so. To date, regulators have embraced plans that will allow the utility to increase its rate base at a compound annual rate of 8% to 11% per year from 2011 to 2014, offering management an important path to stock price appreciation, which may be especially valuable to management given the market's expectation that struggling EME will contribute little to consolidated earnings over the next few years.

As a result of these pressures, we could revise the business profile to strong from excellent.

Over the next two years, we expect SCE to maintain its significant financial profile, but it too is under pressure. If SCE executes on its proposed capital program, it will do so by increasing leverage. The benefits of deferred taxes and bonus depreciation will assist the company in achieving healthy credit metrics in 2011 and 2012, with FFO to total debt at comfortably more than 20% and FFO interest coverage at more than 4x. We expect fully adjusted debt to total capitalization to remain about 56% this year, but we expect it to begin to creep up in 2012 and 2013, reflecting continued use of short-term borrowings to fund capital investments, if approved as requested in the GRC. Debt to total capitalization could reach, and possibly exceed, 60% on a fully adjusted basis as early as 2013.

And although some of the additional leverage results from an expected increase in debt equivalents that we impute on the company as its power procurement obligations increase, even on a reported basis, we expect leverage to increase as a function of its five-year capital plan. We view increasing leverage as removing a level of financial flexibility that has been an important tool in weathering the recession.

California's regulatory framework continues to be an important source of support for the rating. Despite a reshuffling of commissioners this year, our expectations are that ratemaking will continue to be constructive at the CPUC. Supportive regulatory mechanisms established by the CPUC allow SCE timely and certain recovery of costs. These mechanisms include:

- The use of forward test years for CPUC rate cases over a three-year period;
- A fuel and purchased power mechanism that quickly adjusts if costs are higher than projected;
- Single-issue rate cases for large projects such as SCE's smart meter installation and SONGS steam generator replacement;
- A formulaic, multiyear cost-of-capital mechanism (not due to reset until 2013); and
- The decoupling of electric revenues and sales and advance approval of procurement plans (e.g., if upfront prudency review occurs).

The FERC has also provided SCE with supportive incentives to build its transmission projects, including bonus return on equity (ROE) rewards, recovery of construction work in progress, and 100% recovery of costs in case of abandonment for three of SCE's largest transmission projects.

SCE is owned by Edison International (EIX; BBB-/Stable). The two-notch differential between the EIX rating and the utility ratings reflects our view that structural protections in place at the utility provide a degree of insulation from the weaker parent. These protections include a non-consolidation opinion and a CPUC restriction requiring SCE to maintain at least a 48% equity layer to make distributions to its parent, based on its most recent cost-of-capital decision. These and other requirements placed on the parent in a 1988 CPUC holding company decision allow us to assign the maximum number of notches of separation (two) between the EIX rating and the SCE rating.

We expect this two-notch differential to be maintained unless EIX were to support EME. We view EIX management as unlikely to do so because its economic incentives are weak and because EIX's support of EME would compromise the ratings on SCE and likely entail consequences for its regulatory relationships with the CPUC and the FERC, which look to the utility to maintain a strong credit profile. Management's recent public statements echo that EME must be self-supporting.

Liquidity

The SCE short-term rating is 'A-2'. We view SCE's consolidated liquidity as strong under our corporate liquidity methodology, which categorizes liquidity under five standard descriptors. As of March 31, 2011, projected sources of liquidity (mainly operating cash flow and available bank lines) exceeded projected uses (mainly necessary capital expenditures, debt maturities, and common dividends) by more than 1.5x. Its liquidity reflects adequate untapped credit lines that do not expire until 2013 and the absence of any major maturities at SCE until 2004.

SCE has two revolving credit facilities: a $2.4 billion five-year facility that terminates in February 2013, with four separate one-year options to extend by mutual consent, and a $500 million three-year facility that terminates March 2013. As of March 31, 2011, $2.6 billion was available.

Accounting

SCE's financial statements are in accordance with U.S. generally accepted accounting principles (GAAP) and are audited by PricewaterhouseCoopers LLP, which has issued unqualified opinions on the company's financial statements and internal controls for 2010.

Our analysis of the company's financial statements entails several adjustments, the largest of which is the imputation of debt for fixed off-balance-sheet power purchase contracts, pension underfunding, and operating lease obligations.

For 2010, about $1.5 billion of debt was imputed in relation with fixed obligations related to SCE's power purchase agreements. We also imputed about $389 million attributable to operating lease obligations, and $881 million for other postretirement employee benefit obligations. We do not impute debt associated with California Department of Water Resources (CDWR) contracts. As the utility's net short position grows in coming years, particularly as CDWR contracts expire, we expect off-balance-sheet obligations to increase significantly, especially in 2012. We view SCE's preferred and preference securities as having intermediate equity content, ascribing 50% of the amount to debt and the remaining 50% to equity for ratio computation purposes. Similarly, we treat the associated distributions as 50% interest and 50% dividends.

Outlook

The stable outlook reflects our expectation that a supportive state and federal regulatory environment will continue. We expect SCE to sustain utility ratios of at least 18% FFO to total debt and 3.5x FFO interest coverage. If capital investment occurs at levels requested in SCE's current rate case, leverage could touch or slightly exceed 60% as soon as 2013. We would likely lower the ratings if this level of leverage were to persist. A better view of SCE's borrowing requirements and thus leverage will be available when the GRC ruling is finalized, as this will have significant implications for spending and revenue requirements for 2012 through 2014. We do not foresee improvement in the SCE ratings over our outlook horizon due to the utility's sizable capital expansion. If EIX were to support EME, we would lower the SCE ratings at least a notch.

Recovery analysis

We rate SCE's first mortgage bonds (FMB) 'A', two notches higher than the issuer credit rating, with a recovery rating of '1+.' We assign recovery ratings to FMBs issued by U.S. utilities, and this can result in issue ratings being notched above the CCR on a utility, depending on the CCR category and the extent of the collateral coverage. The investment-grade FMB recovery methodology is based on the historical record of nearly 100% recovery for secured-bond holders in utility bankruptcies and our view that the factors that supported those recoveries (small size of the creditor class and the durable value of utility rate-based assets during and after a reorganization, given the essential service provided and the high replacement cost) will persist. Under our notching criteria, we consider the limitations of FMB issuance under the utility's indenture relative to the value of the collateral pledged to bondholders, management's stated intentions on future FMB issuance, and the regulatory limitations on bond issuance when assigning issue ratings to utility FMBs. FMB ratings can exceed a utility CCR by as much as one notch in the 'A' category, two notches in the 'BBB' category, and three notches in speculative-grade categories. (See "Criteria: Changes To Collateral Coverage Requirements For '1+' Recovery Ratings On U.S. Utility First Mortgage Bonds," published Sept. 6, 2007, on RatingsDirect on the Global Credit Portal.) SCE's collateral coverage exceeds 1.5x and supports a recovery rating of '1+' and an issue rating of 'A', one notch above the CCR.

Table 1.

Southern California Edison Co. -- Peer Comparison				
	Southern California Edison Co.	Pacific Gas & Electric Co.	San Diego Gas & Electric Co.	Florida Power & Light Co.
Rating as of July 6, 2011	BBB+/Stable/A-2	BBB+/Negative/A-2	A/Stable/A-1	A-/Stable/A-2

Table 1.

Southern California Edison Co. -- Peer Comparison (cont.)

	--Average of past three fiscal years--			
(Mil. $)				
Revenues	10,398.7	13,520.2	3,072.0	11,208.3
EBITDA	3,396.1	4,237.3	1,044.7	2,675.0
Net income from cont. oper.	1,034.3	1,190.0	355.7	855.0
Funds from operations (FFO)	2,912.5	3,277.6	745.7	2,149.5
Capital expenditures	3,156.6	4,030.8	1,005.1	2,579.0
Free operating cash flow	(327.8)	(1,441.2)	(337.5)	(362.9)
Discretionary cash flow	(703.4)	(2,084.2)	(392.5)	(624.6)
Cash and short-term investments	780.7	145.7	63.7	74.3
Debt	11,204.9	14,923.8	3,406.1	6,609.7
Equity	8,118.3	10,768.7	3,004.3	8,772.0
Adjusted ratios				
EBITDA margin (%)	32.7	31.3	34.0	23.9
EBITDA interest coverage (x)	4.2	4.8	5.3	6.9
EBIT interest coverage (x)	2.7	3.0	3.7	4.4
Return on capital (%)	9.9	9.3	10.8	9.5
FFO/debt (%)	26.0	22.0	21.9	32.5
Free operating cash flow/debt (%)	(2.9)	(9.7)	(9.9)	(5.5)
Debt/EBITDA (x)	3.3	3.5	3.3	2.5
Total debt/debt plus equity (%)	58.0	58.1	53.1	43.0

Table 2.

Southern California Edison Co. -- Financial Summary

	--Fiscal year ended Dec. 31--				
	2010	**2009**	**2008**	**2007**	**2006**
Rating history	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2
(Mil. $)					
Revenues	9,983.0	9,965.0	11,248.0	10,218.1	10,038.3
EBITDA	3,542.1	3,539.1	3,107.2	2,938.0	2,919.2
Net income from continuing operations	1,092.0	1,277.0	734.0	758.0	827.0
Funds from operations (FFO)	3,359.9	3,827.2	1,550.4	2,206.2	1,725.0
Capital expenditures	4,017.1	3,085.1	2,367.7	2,426.6	2,352.4
Dividends paid	326.0	450.5	350.5	160.5	279.6
Debt	11,105.38	10,260.43	12,248.99	7,997.06	8,217.64
Preferred stock	460.0	460.0	460.0	464.5	563.0
Equity	8,747.0	8,255.0	7,353.0	7,138.5	6,361.0
Debt and equity	19,852.4	18,515.4	19,602.0	15,135.6	14,578.6
Adjusted ratios					
EBITDA margin (%)	35.5	35.5	27.6	28.8	29.1

Table 2.

Southern California Edison Co. -- Financial Summary (cont.)					
EBIT interest coverage (x)	2.7	2.8	2.5	2.7	3.0
FFO int. cov. (x)	4.7	5.1	2.6	3.4	2.9
FFO/debt (%)	30.3	37.3	12.7	27.6	21.0
Discretionary cash flow/debt (%)	(11.4)	2.5	(9.0)	1.0	(6.2)
Net cash flow/capex (%)	75.5	109.5	50.7	84.3	61.4
Debt/debt and equity (%)	55.9	55.4	62.5	52.8	56.4
Return on capital (%)	9.6	10.6	9.4	11.8	13.7
Return on common equity (%)	11.2	15.1	9.4	10.9	15.0
Common dividend payout ratio (unadj.; %)	19.2	34.7	58.6	14.1	36.3

Table 3.

Reconciliation Of Southern California Edison Co. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. $)

	--Fiscal year ended Dec. 31, 2010--								
Southern California Edison Co. reported amounts									
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**	**Dividends paid**
Reported	7,627.0	9,207.0	9,983.0	3,136.0	1,863.0	429.0	3,386.0	3,386.0	352.0
Standard & Poor's adjustments									
Operating leases	389.1	--	--	19.9	19.9	19.9	36.1	36.1	--
Intermediate hybrids reported as equity	460.0	(460.0)	--	--	--	26.0	(26.0)	(26.0)	(26.0)
Postretirement benefit obligations	880.8	--	--	(16.0)	(16.0)	13.0	(15.0)	(15.0)	--
Capitalized interest	--	--	--	--	--	41.0	(41.0)	(41.0)	--
Share-based compensation expense	--	--	--	27.0	--	--	--	--	--
Power purchase agreements	1,510.0	--	--	180.2	97.3	97.3	82.9	82.9	--
Asset retirement obligations	69.6	--	--	195.0	195.0	195.0	(126.1)	(126.1)	--
Reclassification of nonoperating income (expenses)	--	--	--	--	97.0	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	282.0	--
US decommissioning fund contributions	--	--	--	--	--	--	(219.0)	(219.0)	--
Debt - Accrued interest not included in reported debt	169.0	--	--	--	--	--	--	--	--
Total adjustments	3,478.4	(460.0)	0.0	406.1	393.2	392.2	(308.1)	(26.1)	(26.0)

Table 3.

Reconciliation Of Southern California Edison Co. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. $) (cont.)

Standard & Poor's adjusted amounts

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid
Adjusted	11,105.4	8,747.0	9,983.0	3,542.1	2,256.2	821.2	3,077.9	3,359.9	326.0

Related Criteria And Research

- Corporate Criteria--Parent/Subsidiary Links; General Principles; Subsidiaries/Joint Ventures/Nonrecourse Projects; Finance Subsidiaries; Rating Link to Parent, Oct. 28, 2004
- Differentiating The Issuer Credit Ratings Of A Regulated Utility Subsidiary And Its Parent, March 11, 2010
- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010

Ratings Detail (As Of July 28, 2011)*	
Southern California Edison Co.	
Corporate Credit Rating	BBB+/Stable/A-2
Commercial Paper	
Local Currency	A-2
Preference Stock (1 Issue)	BBB-
Preferred Stock (9 Issues)	BBB-
Senior Secured (33 Issues)	A
Senior Secured (3 Issues)	AA+/Stable
Senior Secured (1 Issue)	BBB+
Senior Unsecured (10 Issues)	BBB+
Corporate Credit Ratings History	
16-Feb-2005	BBB+/Stable/A-2
17-Dec-2003	BBB/Stable/A-2
03-Dec-2003	BBB/Stable/NR
Business Risk Profile	Excellent
Financial Risk Profile	Significant
Related Entities	
Edison International	
Issuer Credit Rating	BBB-/Stable/NR
Senior Unsecured (1 Issue)	BBB-
Edison Mission Energy	
Issuer Credit Rating	B-/Negative/NR
Senior Secured (1 Issue)	B+
Senior Unsecured (5 Issues)	B-
Edison Mission Marketing and Trading	
Issuer Credit Rating	B-/Negative/--

Ratings Detail (As Of July 28, 2011)*(cont.)	
Homer City Funding LLC	
Senior Secured (2 Issues)	B+/Negative
Midwest Generation LLC	
Issuer Credit Rating	B-/Negative/--
Senior Secured (1 Issue)	B+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.