EDISON INTERNATIONAL
Form 10-Q
November 07, 2008
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2008**

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to**

**Commission File Number 1-9936**

# EDISON INTERNATIONAL

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **California**<br>**(State or other jurisdiction of**<br>**incorporation or organization)** | **95-4137452**<br>**(I.R.S. Employer**<br>**Identification No.)** |
| **2244 Walnut Grove Avenue**<br>**(P. O. Box 976)**<br>**Rosemead, California**<br>**(Address of principal executive offices)** | **91770**<br>**(Zip Code)** |

**(626) 302-2222**

**(Registrant s telephone number, including area code)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer x | Accelerated filer ¨ | Non-accelerated filer ¨<br>(Do not check if a smaller reporting company) | Smaller reporting company ¨ |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

| Class | Outstanding at November 5, 2008 |
|---|---|
| **Common Stock, no par value** | **325,811,206** |

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## GLOSSARY

When the following terms and abbreviations appear in the text of this report, they have the meanings indicated below.

| | |
|---|---|
| AB | Assembly Bill |
| AFUDC | allowance for funds used during construction |
| APS | Arizona Public Service Company |
| ARO(s) | asset retirement obligation(s) |
| Btu | British thermal units |
| CAA | Clean Air Act |
| CAIR | Clean Air Interstate Rule |
| CARB | California Air Resources Board |
| Commonwealth Edison | Commonwealth Edison Company |
| CDWR | California Department of Water Resources |
| CEC | California Energy Commission |
| CONE | Cost of new entry |
| CPSD | Consumer Protection and Safety Division |
| CPUC | California Public Utilities Commission |
| CRRs | Congestion revenue rights |
| D.C. District Court | U.S. District Court for the District of Columbia |
| DOE | United States Department of Energy |
| DOJ | United States Department of Justice |
| DPV2 | Devers-Palo Verde II |
| DRA | Division of Ratepayer Advocates |
| DWP | Los Angeles Department of Water & Power |
| EME | Edison Mission Energy |
| EME Homer City | EME Homer City Generation L.P. |
| EMG | Edison Mission Group Inc. |
| EMMT | Edison Mission Marketing & Trading, Inc. |
| EPS | earnings per share |
| ERRA | energy resource recovery account |
| Exelon Generation | Exelon Generation Company LLC |
| FASB | Financial Accounting Standards Board |
| FERC | Federal Energy Regulatory Commission |
| FGIC | Financial Guarantee Insurance Company |
| FIN 39-1 | Financial Accounting Standards Board Interpretation No. 39-1, Amendment of FASB Interpretation No. 39 |
| FIN 48 | Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FAS 109 |
| FSP SFAS No. 133-1 and FIN No. 45-4 | Financial Accounting Standards Board Staff Position No. 133-1 and FIN No. 45-4, Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161. |
| FSP SFAS 142-3 | FASB Staff Position No. SFAS 142-3, Determination of the Useful Life of Intangible Assets |
| GAAP | general accepted accounting principles |
| GHG | greenhouse gas |
| Global Settlement | A settlement currently being negotiated between Edison International and the IRS, which, if consummated, would resolve asserted deficiencies related to Edison International s deferral of income taxes associated with certain of its cross-border, leveraged leases and all other outstanding tax disputes for open tax years 1986 through 2002, including certain affirmative claims for unrecognized tax benefits. There can be no assurance about the timing of such settlement or that a final settlement will be ultimately consummated. |

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**GLOSSARY (Continued)**

| | |
|---|---|
| GRC | General Rate Case |
| GWh | gigawatt-hours |
| Illinois plants | EME s largest power plants (fossil fuel) located in Illinois |
| IRS | Internal Revenue Service |
| ISO | California Independent System Operator |
| kWh(s) | kilowatt-hour(s) |
| MD&A | Management s Discussion and Analysis of Financial Condition and Results of Operations |
| MEHC | Mission Energy Holding Company |
| Midway-Sunset | Midway-Sunset Cogeneration Company |
| Midwest Generation | Midwest Generation, LLC |
| MMBtu | million British thermal units |
| Mohave | Mohave Generating Station |
| Moody s | Moody s Investors Service |
| MRTU | Market Redesign and Technology Upgrade |
| MW | Megawatts |
| MWh | megawatt-hours |
| NOV | notice of violation |
| $NO_x$ | nitrogen oxide |
| NRC | Nuclear Regulatory Commission |
| NYISO | New York Independent System Operator |
| Palo Verde | Palo Verde Nuclear Generating Station |
| PBOP(s) | Postretirement benefits other than pension(s) |
| PBR | performance-based ratemaking |
| PG&E | Pacific Gas & Electric Company |
| PJM | PJM Interconnection, LLC |
| POD | Presiding Officer s Decision |
| PRB | Powder River Basin |
| PX | California Power Exchange |
| QF(s) | qualifying facility(ies) |
| RICO | Racketeer Influenced and Corrupt Organization |
| ROE | return on equity |
| RPM | reliability pricing model |
| S&P | Standard & Poor s |
| SCAQMD | South Coast Air Quality Management District |
| San Onofre | San Onofre Nuclear Generating Station |
| SCE | Southern California Edison Company |
| SDG&E | San Diego Gas & Electric |
| SFAS | Statement of Financial Accounting Standards issued by the FASB |
| SFAS No. 133 | Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities |
| SFAS No. 141(R) | Statement of Financial Accounting Standards No. 141(R), Business Combinations |
| SFAS No. 157 | Statement of Financial Accounting Standards No. 157, Fair Value Measurements |
| SFAS No. 158 | Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans |
| SFAS No. 159 | Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities |

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**GLOSSARY (Continued)**

| | |
|---|---|
| SFAS No. 160 | Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements |
| SFAS No. 161 | Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 |
| SIP(s) | State Implementation Plan(s) |
| $SO_2$ | sulfur dioxide |
| TURN | The Utility Reform Network |
| US EPA | United States Environmental Protection Agency |
| VIE(s) | variable interest entity(ies) |

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**EDISON INTERNATIONAL**

**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**CONSOLIDATED STATEMENTS OF INCOME**

| In millions, except per-share amounts | Three Months Ended September 30, 2008 | 2007 | Nine Months Ended September 30, 2008 | 2007 |
|---|---|---|---|---|
| | | (Unaudited) | | |
| Electric utility | **$ 3,284** | $ 3,213 | **$ 8,388** | $ 7,895 |
| Nonutility power generation | **813** | 711 | **2,143** | 1,952 |
| Financial services and other | **14** | 18 | **45** | 55 |
| **Total operating revenue** | **4,111** | 3,942 | **10,576** | 9,902 |
| Fuel | **635** | 502 | **1,725** | 1,425 |
| Purchased power | **1,962** | 1,284 | **3,111** | 2,431 |
| Provisions for regulatory adjustment clauses net | **(737)** | (66) | **(286)** | 189 |
| Other operation and maintenance | **1,025** | 1,013 | **3,109** | 2,893 |
| Depreciation, decommissioning and amortization | **262** | 310 | **893** | 937 |
| (Gain) on buyout of contract and (gain)/loss on sale of assets | **(1)** | 1 | **(75)** | |
| **Total operating expenses** | **3,146** | 3,044 | **8,477** | 7,875 |
| **Operating income** | **965** | 898 | **2,099** | 2,027 |
| Interest and dividend income | **9** | 40 | **44** | 125 |
| Equity in income from partnerships and unconsolidated subsidiaries net | **31** | 35 | **40** | 72 |
| Other nonoperating income | **23** | 35 | **78** | 75 |
| Interest expense net of amounts capitalized | **(176)** | (191) | **(511)** | (577) |
| Loss on early extinguishment of debt | | | | (241) |
| Other nonoperating deductions | **(82)** | (7) | **(115)** | (31) |
| **Income from continuing operations before tax and minority interest** | **770** | 810 | **1,635** | 1,450 |
| Income tax expense | **277** | 263 | **521** | 392 |
| Dividends on preferred and preference stock of utility not subject to mandatory redemption | **13** | 13 | **38** | 38 |
| Minority interest | **47** | 69 | **77** | 134 |
| **Income from continuing operations** | **433** | 465 | **999** | 886 |
| Income (loss) from discontinued operations net of tax | **6** | (4) | | 1 |
| **Net income** | **$ 439** | $ 461 | **$ 999** | $ 887 |
| **Weighted-average shares of common stock outstanding** | **326** | 326 | **326** | 326 |
| **Basic earnings (loss) per common share:** | | | | |
| Continuing operations | **$ 1.31** | $ 1.41 | **$ 3.03** | $ 2.69 |
| Discontinued operations | **0.02** | (0.01) | | |
| **Total** | **$ 1.33** | $ 1.40 | **$ 3.03** | $ 2.69 |
| **Weighted-average shares, including effect of dilutive securities** | **328** | 330 | **329** | 331 |
| **Diluted earnings (loss) per common share:** | | | | |
| Continuing operations | **$ 1.31** | $ 1.40 | **$ 3.02** | $ 2.67 |
| Discontinued operations | **0.02** | (0.01) | | |
| **Total** | **$ 1.33** | $ 1.39 | **$ 3.02** | $ 2.67 |
| Dividends declared per common share | **$ 0.305** | $ 0.29 | **$ 0.915** | $ 0.87 |

The accompanying notes are an integral part of these consolidated financial statements.

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**EDISON INTERNATIONAL**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

| In millions | Three Months Ended September 30, 2008 | Three Months Ended September 30, 2007 | Nine Months Ended September 30, 2008 | Nine Months Ended September 30, 2007 |
|---|---|---|---|---|
| | | (Unaudited) | | |
| Net income | **$ 439** | $ 461 | **$ 999** | $ 887 |
| Other comprehensive income (loss), net of tax: | | | | |
| Foreign currency translation adjustments-net | **(1)** | 1 | **(4)** | (1) |
| Pension and postretirement benefits other than pensions: | | | | |
| Amortization of net gain (loss) and prior service cost included in expense-net | | | | 1 |
| Unrealized gains (losses) on cash flow hedges: | | | | |
| Other unrealized gains (losses) arising during the period net of income tax expense (benefit) of $357 and $(17) for the three months and $53 and $(102) for the nine months ended September 30, 2008 and 2007, respectively | **535** | (28) | **81** | (149) |
| Reclassification adjustments included in net income net of income tax expense (benefit) of $(44) and $8 for the three months and $45 and $27 for the nine months ended September 30, 2008 and 2007, respectively | **(65)** | 12 | **69** | 38 |
| Other comprehensive income (loss) | **469** | (15) | **146** | (111) |
| **Comprehensive income** | **$ 908** | $ 446 | **$ 1,145** | $ 776 |

The accompanying notes are an integral part of these consolidated financial statements.

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**CONSOLIDATED BALANCE SHEETS**

| In millions | September 30, 2008 (Unaudited) | December 31, 2007 |
|---|---|---|
| **ASSETS** | | |
| Cash and equivalents | **$ 3,464** | $ 1,441 |
| Short-term investments | **23** | 81 |
| Receivables, less allowance of $33 and $34 for uncollectible accounts at respective dates | **1,339** | 1,033 |
| Accrued unbilled revenue | **518** | 370 |
| Fuel inventory | **138** | 116 |
| Materials and supplies | **376** | 316 |
| Derivative assets | **232** | 109 |
| Restricted cash | **3** | 3 |
| Margin and collateral deposits | **157** | 121 |
| Regulatory assets | **454** | 197 |
| Accumulated deferred income taxes net | **190** | 167 |
| Other current assets | **189** | 290 |
| **Total current assets** | **7,083** | 4,244 |
| Nonutility property less accumulated provision for depreciation of $1,949 and $1,765 at respective dates | **5,257** | 4,906 |
| Nuclear decommissioning trusts | **2,855** | 3,378 |
| Investments in partnerships and unconsolidated subsidiaries | **260** | 272 |
| Investments in leveraged leases | **2,460** | 2,473 |
| Other investments | **110** | 96 |
| **Total investments and other assets** | **10,942** | 11,125 |
| Utility plant, at original cost: | | |
| Transmission and distribution | **19,776** | 18,940 |
| Generation | **1,820** | 1,767 |
| Accumulated provision for depreciation | **(5,526)** | (5,174) |
| Construction work in progress | **1,970** | 1,693 |
| Nuclear fuel, at amortized cost | **246** | 177 |
| **Total utility plant** | **18,286** | 17,403 |
| Derivative assets | **206** | 122 |
| Restricted cash | **43** | 48 |
| Rent payments in excess of levelized rent expense under plant operating leases | **878** | 716 |
| Regulatory assets | **2,880** | 2,721 |
| Other long-term assets | **1,348** | 1,144 |
| **Total long-term assets** | **5,355** | 4,751 |
| **Total assets** | **$ 41,666** | $ 37,523 |

The accompanying notes are an integral part of these consolidated financial statements.

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**EDISON INTERNATIONAL**

**CONSOLIDATED BALANCE SHEETS**

| In millions, except share amounts | September 30, 2008 (Unaudited) | December 31, 2007 |
|---|---|---|
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| Short-term debt | $ 1,808 | $ 500 |
| Long-term debt due within one year | 173 | 18 |
| Accounts payable | 939 | 979 |
| Accrued taxes | 177 | 49 |
| Accrued interest | 211 | 160 |
| Counterparty collateral | 9 | 42 |
| Customer deposits | 227 | 219 |
| Book overdrafts | 298 | 212 |
| Derivative liabilities | 175 | 125 |
| Regulatory liabilities | 1,179 | 1,019 |
| Other current liabilities | 931 | 933 |
| **Total current liabilities** | 6,127 | 4,256 |
| **Long-term debt** | 10,523 | 9,016 |
| Accumulated deferred income taxes net | 5,521 | 5,196 |
| Accumulated deferred investment tax credits | 185 | 114 |
| Customer advances | 134 | 155 |
| Derivative liabilities | 52 | 101 |
| Power-purchase contracts | 21 | 22 |
| Accumulated provision for pensions and benefits | 1,166 | 1,089 |
| Asset retirement obligations | 2,997 | 2,892 |
| Regulatory liabilities | 2,889 | 3,433 |
| Other deferred credits and other long-term liabilities | 1,544 | 1,595 |
| **Total deferred credits and other liabilities** | 14,509 | 14,597 |
| **Total liabilities** | 31,159 | 27,869 |
| Commitments and contingencies (Note 5) | | |
| **Minority interest** | 319 | 295 |
| **Preferred and preference stock of utility not subject to mandatory redemption** | 907 | 915 |
| Common stock, no par value (325,811,206 shares outstanding at each date) | 2,263 | 2,225 |
| Accumulated other comprehensive income (loss) | 54 | (92) |
| Retained earnings | 6,964 | 6,311 |
| **Total common shareholders equity** | 9,281 | 8,444 |
| **Total liabilities and shareholders equity** | $ 41,666 | $ 37,523 |

The accompanying notes are an integral part of these consolidated financial statements.

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**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| In millions | Nine Months Ended September 30, 2008 | 2007 |
|---|---|---|
| | (Unaudited) | |
| **Cash flows from operating activities:** | | |
| Net income | **$ 999** | $ 887 |
| Less: Income from discontinued operations | | 1 |
| Income from continuing operations | **999** | 886 |
| Adjustments to reconcile to net cash provided by operating activities: | | |
| Depreciation, decommissioning and amortization | **893** | 937 |
| Other-than-temporary impairment on nuclear decommissioning trusts | **121** | 42 |
| Other amortization | **80** | 94 |
| Stock-based compensation | **25** | 28 |
| Minority interest | **77** | 134 |
| Deferred income taxes and investment tax credits | **69** | (83) |
| Equity in income from partnerships and unconsolidated subsidiaries | **(40)** | (72) |
| (Gain) on buyout of contract and (gain)/loss on sale of assets | **(75)** | |
| Income from leveraged leases | **(39)** | (46) |
| Levelized rent expense | **(162)** | (161) |
| Loss on early extinguishment of debt | | 241 |
| Regulatory assets | **(246)** | 312 |
| Regulatory liabilities | **122** | 312 |
| Derivative assets | **(60)** | 3 |
| Derivative liabilities | **86** | (105) |
| Other assets | **(71)** | (25) |
| Other liabilities | **(14)** | 252 |
| Margin and collateral deposits net of collateral received | **(70)** | 28 |
| Receivables and accrued unbilled revenue | **(378)** | (467) |
| Inventory and other current assets | **18** | (55) |
| Book overdrafts | **90** | 113 |
| Accrued interest and taxes | **179** | 366 |
| Accounts payable and other current liabilities | **(16)** | (46) |
| Distributions and dividends from unconsolidated entities | **9** | 43 |
| Operating cash flows from discontinued operations | | 1 |
| **Net cash provided by operating activities** | **1,597** | 2,732 |
| **Cash flows from financing activities:** | | |
| Long-term debt issued | **2,132** | 2,930 |
| Premium paid on extinguishment of debt and long-term debt issuance costs | **(15)** | (240) |
| Long-term debt repaid | **(246)** | (3,061) |
| Bonds repurchased | **(212)** | |
| Preferred stock redeemed | **(7)** | |
| Short-term debt financing-net | **1,308** | |
| Rate reduction notes repaid | | (178) |
| Shares purchased for stock-based compensation | **(57)** | (195) |
| Proceeds from stock option exercises | **23** | 77 |
| Excess tax benefits related to stock-based awards | **12** | 39 |
| Dividends to minority shareholders | **(78)** | (76) |
| Dividends paid | **(298)** | (283) |
| **Net cash provided (used) by financing activities** | **$ 2,562** | $ (987) |

The accompanying notes are an integral part of these consolidated financial statements.

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**EDISON INTERNATIONAL**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| In millions | Nine Months Ended September 30, 2008 | 2007 |
|---|---|---|
| | (Unaudited) | |
| **Cash flows from investing activities:** | | |
| Capital expenditures | **$ (1,959)** | $ (1,979) |
| Purchase of interest of acquired companies | **(11)** | (28) |
| Proceeds from sale of property and interests in projects | **113** | |
| Proceeds from nuclear decommissioning trust sales | **2,279** | 2,866 |
| Purchases of nuclear decommissioning trust investments and other | **(2,329)** | (2,967) |
| Proceeds from partnerships and unconsolidated subsidiaries, net of investment | **35** | 17 |
| Maturities and sales of short-term investments | **80** | 7,380 |
| Purchase of short-term investments | **(22)** | (7,174) |
| Restricted cash | **4** | 35 |
| Customer advances for construction and other investments | **(326)** | (232) |
| **Net cash used by investing activities** | **(2,136)** | (2,082) |
| **Net increase (decrease) in cash and equivalents** | **2,023** | (337) |
| Cash and equivalents, beginning of period | **1,441** | 1,795 |
| **Cash and equivalents, end of period** | **$ 3,464** | $ 1,458 |

The accompanying notes are an integral part of these consolidated financial statements.

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**EDISON INTERNATIONAL**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Management s Statement**

In the opinion of management, all adjustments, including recurring accruals, have been made that are necessary to fairly state the consolidated financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States of America for the periods covered by this quarterly report on Form 10-Q. The results of operations for the three- and nine-month periods ended September 30, 2008 are not necessarily indicative of the operating results for the full year.

This quarterly report should be read in conjunction with Edison International s Annual Report to Shareholders incorporated by reference into Edison International s Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission.

**Note 1. Summary of Significant Accounting Policies**

***Basis of Presentation***

Edison International s significant accounting policies were described in Note 1 of Notes to Consolidated Financial Statements included in its 2007 Annual Report on Form 10-K. Edison International follows the same accounting policies for interim reporting purposes, with the exception of accounting principles adopted as of January 1, 2008 as discussed below in Margin and Collateral Deposits and New Accounting Pronouncements.

The December 31, 2007 condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Certain prior-year reclassifications have been made to conform to the current year financial statement presentation mostly pertaining to the adoption of FIN No. 39-1. Except as indicated, amounts presented in the Notes to the Consolidated Financial Statements relate to continuing operations.

***Cash Equivalents and Short-term Investments***

At September 30, 2008, cash equivalents included U.S. treasury and government agency securities, U.S. treasury and government agency money market funds and commercial paper totaling $3.0 billion. At December 31, 2007, cash equivalents included money market funds, time deposits (including certificates of deposit) and U.S. treasury securities totaling $993 million. Cash equivalents, with the exception of money market funds, were stated at cost plus accrued interest. The carrying value of cash equivalents approximates fair value due to maturities of less than three months. For further discussion of money market funds, see Note 8.

At September 30, 2008 and December 31, 2007, Edison International classified all marketable debt securities as held-to-maturity. The securities were carried at amortized cost plus accrued interest which approximated their fair value. Gross unrealized holding gains and losses were not material.

Edison International s short-term investments consisted of the following:

| In millions | **September 30, 2008** (Unaudited) | **December 31, 2007** |
|---|---|---|
| Commercial paper | **$ 1** | $ 32 |
| Certificates of deposit | | 41 |
| U.S. Treasury securities | | 7 |
| Time deposits | **3** | |

| | | |
|---|---|---|
| Money market funds | **19** | |
| Corporate bonds | | 1 |
| **Total** | **$ 23** | $ 81 |

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***Earnings Per Common Share***

Edison International computes EPS using the two-class method, which is an earnings allocation formula that determines EPS for each class of common stock and participating security. Edison International s participating securities are stock-based compensation awards payable in common shares, including stock options, performance shares and restricted stock units, which earn dividend equivalents on an equal basis with common shares. Stock options awarded during the period 2003 through 2006 received dividend equivalents. Stock options awarded prior to 2002 and after 2006 were granted without a dividend equivalent feature. As a result of meeting a performance trigger, the options granted in 1998 and 1999 began earning dividend equivalents in 2006. EPS was computed as follows:

| | **Three Months Ended** | | **Nine Months Ended** | |
|---|---|---|---|---|
| | **September 30,** | | **September 30,** | |
| In millions | **2008** | **2007** | **2008** | **2007** |
| | | (Unaudited) | | |
| **Basic earnings per share continuing operations:** | | | | |
| Income from continuing operations | **$ 433** | $ 465 | **$ 999** | $ 886 |
| Gain on redemption of preferred stock | | | **2** | |
| Participating securities dividends | **(6)** | (6) | **(12)** | (10) |
| Income from continuing operations available to common shareholders | **$ 427** | $ 459 | **$ 989** | $ 876 |
| Weighted average common shares outstanding | **326** | 326 | **326** | 326 |
| **Basic earnings per share continuing operations** | **$ 1.31** | $ 1.41 | **$ 3.03** | $ 2.69 |
| **Diluted earnings per share continuing operations:** | | | | |
| Income from continuing operations available to common shareholders | **$ 427** | $ 459 | **$ 989** | $ 876 |
| Income impact of assumed conversions | **3** | 4 | **6** | 9 |
| Income from continuing operations available to common shareholders and assumed conversions | **$ 430** | $ 463 | **$ 995** | $ 885 |
| Weighted average common shares outstanding | **326** | 326 | **326** | 326 |
| Incremental shares from assumed conversions | **2** | 4 | **3** | 5 |
| Adjusted weighted average shares diluted | **328** | 330 | **329** | 331 |
| **Diluted earnings per share continuing operations** | **$ 1.31** | $ 1.40 | **$ 3.02** | $ 2.67 |

Stock-based compensation awards to purchase 3,874,740 and 37,057 shares of common stock for the three months ended September 30, 2008 and 2007, respectively, and 2,244,291 and 59,577 shares of common stock for the nine months ended September 30, 2008 and 2007, respectively, were outstanding, but were not included in the computation of diluted earnings per share because the exercise price of the awards was greater than the average market price of the common shares; therefore, the effect would have been antidilutive.

***Intangible Assets***

Other current assets on Edison International s consolidated balance sheets includes emission allowances purchased for use by EME of $65 million and $45 million at September, 2008 and December 31, 2007, respectively.

Other long-term assets on Edison International s consolidated balance sheets includes EME s project development rights, option rights, and purchased emission allowances and the total amounted to $74 million and $61 million, at September 30, 2008 and December 31, 2007, respectively.

Based on the CAIR requirements, Midwest Generation purchased annual $NO_X$ allowances under the new CAIR annual $NO_X$ program. Midwest Generation and EME Homer City continue to plan to meet the requirements of

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the CAIR as required under current law effective January 1, 2009. If the District of Columbia Circuit Court issues a mandate to vacate the CAIR, Midwest Generation would no longer need annual $NO_X$ allowances and would record an impairment of $48 million at the time of such action.

***Margin and Collateral Deposits***

Margin and collateral deposits include margin requirements and cash deposited with and received from counterparties and brokers as credit support under energy contracts. The amount of margin and collateral deposits generally varies based on changes in the fair value of the related positions. See New Accounting Pronouncements below for a discussion of the adoption of FIN No. 39-1. In accordance with FIN No. 39-1, Edison International presents a portion of its margin and cash collateral deposits net with its derivative positions on its consolidated balance sheets. Amounts recognized for cash collateral provided to others that have been offset against net derivative liabilities totaled $98 million and $38 million at September 30, 2008 and December 31, 2007, respectively. Amounts recognized for cash collateral received from others that have been offset against net derivative assets totaled were less than $1 million at September 30, 2008.

***New Accounting Pronouncements***

*Accounting Pronouncements Adopted*

In April 2007, the FASB issued FIN No. 39-1. This pronouncement permits companies to offset fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) against fair value amounts recognized for derivative instruments executed with the same counterparty under a master netting arrangement. In addition, upon the adoption, companies were permitted to change their accounting policy to offset or not offset fair value amounts recognized for derivative instruments under master netting agreements. Edison International adopted FIN No. 39-1 effective January 1, 2008. The adoption resulted in netting a portion of margin and cash collateral deposits with derivative positions on Edison International s consolidated balance sheets, but had no impact on its consolidated statements of income. The consolidated balance sheet at December 31, 2007 has been retroactively restated for the change, which resulted in a decrease in net assets (margin and collateral deposits) of $38 million. The consolidated statement of cash flows for the nine months ended September 30, 2007 has been retroactively restated to reflect the balance sheet changes, which had no impact on total operating cash flows from continuing operations.

In February 2007, the FASB issued SFAS No. 159, which provides an option to report eligible financial assets and liabilities at fair value, with changes in fair value recognized in earnings. Edison International adopted this pronouncement effective January 1, 2008. The adoption had no impact because Edison International did not make an optional election to report additional financial assets and liabilities at fair value.

In September 2006, the FASB issued SFAS No. 157, which clarifies the definition of fair value, establishes a framework for measuring fair value and expands the disclosures on fair value measurements. Edison International adopted SFAS No. 157 effective January 1, 2008. The adoption did not result in any retrospective adjustments to its consolidated financial statements. The accounting requirements for employers pension and other postretirement benefit plans are effective at the end of 2008, which is the next measurement date for these benefit plans. The effective date will be January 1, 2009 for asset retirement obligations and other nonfinancial assets and liabilities which are measured or disclosed on a non-recurring basis. For further discussion, see Note 8.

On October 10, 2008, the FASB issued FSP SFAS No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. This position clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. It also reaffirms the notion of fair value as an exit price as of the measurement date. This position was effective upon issuance, including prior periods for which financial statements have not been issued. The adoption had no impact on Edison International s consolidated financial statements.

*Accounting Pronouncements Not Yet Adopted*

In December 2007, the FASB issued SFAS No. 141(R), which establishes principles and requirements for how the acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at the acquisition date fair value. SFAS No. 141(R) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after fiscal years beginning on or after January 1, 2009. Early adoption is not permitted.

In December 2007, the FASB issued SFAS No. 160, which requires an entity to present minority interest that reflects the ownership interests in subsidiaries held by parties other than the entity, within the equity section but separate from the entity s equity in the consolidated financial statements. It also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of income; changes in ownership interest be accounted for similarly as equity transactions; and, when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary and the gain or loss on the deconsolidation of the subsidiary be measured at fair value. Edison International will adopt SFAS No. 160 on January 1, 2009. In accordance with this standard, Edison International will reclassify minority interest to a component of shareholders equity (at September 30, 2008 this amount was $319 million).

In March 2008, the FASB issued SFAS No. 161, which requires additional disclosures related to derivative instruments, including how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for and how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008, with early adoption permitted. Edison International will adopt SFAS No. 161 in the first quarter of 2009. SFAS No. 161 will impact disclosures only and will not have an impact on Edison International s consolidated results of operations, financial condition or cash flows.

In April 2008, the FASB issued FSP FAS No. 142-3 which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets. The intent of the position is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R) and other U.S. generally accepted accounting principles. Edison International will adopt FSP FAS No. 142-3 on January 1, 2009. Edison International is currently evaluating the impact, if any, that the adoption of this position could have on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles, which identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements for nongovernmental entities that are presented in conformity with U.S. GAAP. This statement transfers the GAAP hierarchy from the American Institute of Certified Public Accountants Statement on Auditing Standards No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles to the FASB. SFAS No. 162 is effective on November 15, 2008. Edison International expects that the adoption of this standard will not have an impact on Edison International s consolidated results of operations, financial condition or cash flows.

In September 2008, the FASB issued FSP SFAS No. 133-1 and FIN No. 45-4. FSP SFAS No. 133-1 requires enhanced disclosures by sellers of credit derivatives and amends FASB Interpretation No. 45 (FIN No. 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, to require additional disclosure about the current status of the payment/performance risk of a guarantee. The provisions of the FSP that amend SFAS No. 133 and FIN No. 45 are effective for reporting

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periods ending after November 15, 2008. Since FSP FAS No. 133-1 and FIN No. 45-4 only require additional disclosures, the adoption will not impact Edison International s consolidated financial position, results of operations or cash flows.

***Property and Plant***

*Utility Plant*

Utility plant additions, including replacements and betterments, are capitalized. Such costs include direct material and labor, construction overhead, a portion of administrative and general costs capitalized at a rate authorized by the CPUC, and AFUDC. AFUDC represents the estimated cost of debt and equity funds that finance utility-plant construction. Currently, AFUDC debt and equity is capitalized during certain plant construction and reported in interest expense and other nonoperating income, respectively. AFUDC is recovered in rates through depreciation expense over the useful life of the related asset.

On November 26, 2007, the FERC issued an order granting incentives on three of SCE s largest proposed transmission projects, DPV2, Tehachapi Transmission Project ( Tehachapi ), and Rancho Vista Substation Project ( Rancho Vista ). The order permits SCE to include in rate base 100% of prudently-incurred capital expenditures during construction of all three projects. On February 29, 2008, the FERC approved SCE s revision to its Transmission Owner Tariff to collect 100% of construction work in progress (CWIP) for these projects in rate base and earn a return on equity, rather than capitalizing AFUDC. SCE implemented the CWIP rate, subject to refund, on March 1, 2008. For further discussion, see FERC Transmission Incentives in Note 5.

***Related Party Transactions***

During the first quarter of 2008, a subsidiary of EME was awarded through a competitive bidding process a ten-year power sales contract with SCE for the output of a 479 MW gas-peaking facility located in the City of Industry, California, which is referred to as the Walnut Creek project. The power sales agreement was approved by the CPUC on September 18, 2008 and by the FERC on October 2, 2008. Deliveries under the power sales agreement are expected to commence in 2013.

**Note 2. Liabilities and Lines of Credit**

***Long-Term Debt***

In January 2008, SCE issued $600 million of 5.95% first and refunding mortgage bonds due in 2038. The proceeds were used to repay SCE s outstanding commercial paper of approximately $426 million and for general corporate purposes. In August 2008, SCE issued $400 million of 5.50% first and refunding mortgage bonds due in 2018. The proceeds were used to repay SCE s outstanding commercial paper of approximately $110 million and borrowings under the credit facility of $200 million, as well as for general corporate purposes. In October 2008, SCE issued $500 million of 5.75% first and refunding mortgage bonds due in 2014. The proceeds were used for general corporate purposes.

The interest rates on one issue of SCE s pollution control bonds insured by FGIC, totaling $249 million, were reset every 35 days through an auction process. Due to a loss of confidence in the creditworthiness of

the bond insurers, there was a significant reduction in market liquidity for auction rate bonds and interest rates on these bonds increased. Consequently, SCE purchased in the secondary market $37 million of its auction rate bonds in December 2007 and the remaining $212 million during the first three months of 2008. In March 2008, SCE converted the issue to a variable rate mode and terminated the FGIC insurance policy. SCE continues to hold the bonds which remain outstanding and have not been retired or cancelled.

EME and its subsidiary, Midwest Generation, made borrowings under their credit agreements totaling $898 million to enhance liquidity. Proceeds from these borrowings were invested in U.S. treasury securities, U.S. government agency securities, and money market funds invested directly in U.S. treasury securities and U.S. government agency securities.

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***Short-Term Debt***

SCE s short-term debt is generally used to finance fuel inventories, balancing account undercollections and general, temporary cash requirements including power-purchase payments. At September 30, 2008, the outstanding short-term debt was $1.56 billion at a weighted-average interest rate of 3.53%. This short-term debt is supported by a $2.5 billion credit line. See below in Credit Agreements.

EIX short-term debt is generally used for liquidity purposes. At September 30, 2008, the outstanding short-term debt was $250 million at a weighted-average interest rate of 3.39%. This short-term debt is supported by a $1.5 billion credit line. See below in Credit Agreements.

***Credit Agreements***

During the third quarter of 2008, Edison International (parent) and its subsidiaries, made borrowings under their respective credit agreements. The following table summarizes the status of these credit facilities at September 30, 2008:

| In millions | SCE | EMG (Unaudited) | Edison International (parent) |
|---|---|---|---|
| Commitment | $ 2,500 | $ 1,100 | $ 1,500 |
| Less: Unfunded commitment from Lehman Brothers subsidiary | (81) | (36) | (62) |
| | 2,419 | 1,064 | 1,438 |
| Outstanding borrowings | (1,558) | (898) | (250) |
| Outstanding letters of credit | (233) | (121) | |
| Amount available | $ 628 | $ 45 | $ 1,188 |

On September 15, 2008, Lehman Brothers Holdings filed for protection under Chapter 11 of the U.S. Bankruptcy Code. A subsidiary of Lehman Brothers Holdings, Lehman Brothers Bank, FSB is one of the lenders in SCE s and Edison International (parent) credit agreement representing a total commitment of $106 million and $74 million, respectively. In September 2008, Lehman Brothers Bank, FSB declined SCE s request for funding of the most recent borrowings, or approximately $42 million. This subsidiary fully funded $12 million of Edison International (parent) borrowing request, which remains outstanding.

A subsidiary of Lehman Brothers Holdings, Lehman Commercial Paper Inc., is one of the lenders in EME s credit agreement representing a commitment of $36 million. In September 2008, Lehman Commercial Paper declined requests for funding under EME s credit agreement. Another subsidiary of Lehman Brothers Holdings, Lehman Brothers Commercial Bank, Inc., is one of the lenders in the Midwest Generation working capital facility. This subsidiary fully funded $42 million of Midwest Generation s borrowing requests, which remains outstanding. At September 30, 2008, Lehman Brothers Commercial Bank s share of the amount available to draw under the Midwest Generation working capital facility was $2 million.

**Note 3. Income Taxes**

Edison International s composite federal and state statutory income tax rate was approximately 40% (net of federal benefit for state income taxes) for all periods presented. Edison International s effective tax rate was 39% and 34% for the three- and nine-month periods ended September 30, 2008, as compared to 36% and 31% for the respective periods in 2007. The higher effective income tax rate for the three months ended September 30, 2008 as compared to the respective period in 2007, was primarily due to two SCE non-deductible expenses recorded in 2008, consisting of a penalty assessed by the CPUC (see Investigation Regarding Performance Incentives Rewards in Note 5) and higher lobbying expenses. The higher effective tax rates for the nine months ended September 30, 2008

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as compared to the respective period in 2007, were due to both previously-mentioned non-deductible expenses and reductions in SCE s income tax reserve recorded in the first quarter of 2007 to reflect progress made in an administrative appeal process with the IRS related to the income tax treatment of certain costs associated with environmental remediation and to reflect a settlement of state tax audit issues. The previously mentioned factors causing an increase to the 2008 federal and state effective tax rates as compared to 2007 were partially offset by higher SCE software and property-related flow-through deductions recorded in 2008.

***Accounting for Uncertainty in Income Taxes***

FIN 48 requires an enterprise to recognize, in its financial statements, the best estimate of the impact of a tax position by determining if the weight of the available evidence indicates it is more likely than not, based solely on the technical merits, that the position will be sustained on audit. Edison International has filed affirmative tax claims related to tax positions, which, if accepted, could result in refunds of taxes paid or additional tax benefits for positions not reflected on filed original tax returns. FIN 48 requires the disclosure of all unrecognized tax benefits, which includes the reserves recorded for tax positions on filed tax returns and the unrecognized portion of affirmative claims.

*Unrecognized Tax Benefits*

The following table provides a reconciliation of unrecognized tax benefits from January 1, 2008 to September 30, 2008 and the reasons for such changes:

| In millions | (Unaudited) |
|---|---|
| Balance at January 1, 2008 | $ 2,114 |
| Tax positions taken during the current year | |
| Increases | 75 |
| Decreases | |
| Tax positions taken during a prior year | |
| Increases | 105 |
| Decreases | (129) |
| Decreases for settlements during the period | |
| Reductions for lapses of applicable statute of limitations | |
| **Balance at September 30, 2008** | **$ 2,165** |

The unrecognized tax benefits in the table above reflect affirmative claims related to timing differences of $1.5 billion and $1.6 billion at September 30, 2008 and January 1, 2008, respectively, but have not met the recognition threshold pursuant to FIN 48 and have been denied by the IRS as part of their examinations. These affirmative claims remain unpaid by the IRS and no receivable has been recorded. Edison International has vigorously defended these affirmative claims in IRS administrative appeals proceedings and these claims are included in the ongoing Global Settlement negotiations.

It is reasonably possible that Edison International could resolve, as part of the Global Settlement, or otherwise, with the IRS, all or a portion of the unrecognized tax benefits through tax year 2002 within the next 12 months, which could reduce unrecognized tax benefits by up to $1.4 billion.

The total amount of unrecognized tax benefits as of September 30, 2008 and January 1, 2008 that, if recognized, would have an effective tax rate impact is $207 million and $206 million, respectively.

*Accrued Interest and Penalties*

The total amounts of accrued interest and penalties related to Edison International s income tax reserve were $193 million and $162 million as of September 30, 2008 and January 1, 2008, respectively. The after-tax interest expense recognized and included in income tax expense was $5 million and $18 million for the three- and nine-month periods ended September 30, 2008, respectively.

***Tax Positions being Addressed as Part of Active Examinations, Administrative Appeals and the Global Settlement***

Edison International is challenging certain IRS deficiency adjustments for tax years 1994 1999 with the Administrative Appeals branch of the IRS and Edison International is currently under active IRS examination for tax years 2000 2006. During the third quarter of 2008, the IRS commenced an examination of tax years 2003 2006. In addition, the statute of limitations remains open for tax years 1986 1993, which has allowed Edison International to file certain affirmative claims related to these tax years. Tax years 1986 2002 are included in the scope of the Global Settlement and tax years 2003 2006 are excluded, except for the cross-border lease issues, which for these later tax years are included in the scope of the Global Settlement.

Most of these tax positions relate to timing differences and, therefore, any amounts exclusive of any penalties that would be paid if Edison International s position is not sustained would be deductible on future tax returns filed by Edison International. In addition, Edison International has filed affirmative claims with respect to certain tax years 1986 through 2005 with the IRS and state tax authorities. Any benefits associated with these affirmative claims would be recorded in accordance with FIN 48 which provides that recognition would occur at the earlier of when Edison International would make an assessment that the affirmative claim position has a more likely than not probability of being sustained or when a settlement of the affirmative claim is consummated with the tax authority. Certain of these affirmative claims have been recognized as part of the implementation of FIN 48.

Currently, Edison International is under administrative appeals with the California Franchise Tax Board for tax years 1997 2002 and under examination for tax years 2003 2004. Edison International remains subject to examination by the California Franchise Tax Board for tax years 2005 and forward. Edison International is also subject to examination by other state tax authorities, subject to varying statute of limitations.

Edison International filed amended California Franchise tax returns for tax years 1997 2002 to mitigate the possible imposition of California non-economic substance penalty provisions on transactions that may be considered as Listed or substantially similar to Listed Transactions described in an IRS notice that was published in 2001. These transactions include certain Edison Capital leveraged lease transactions and the SCE subsidiary contingent liability company transaction, described below. Edison International filed these amended returns under protest retaining its appeal rights.

*Balancing Account Over-Collections*

In response to an affirmative claim filed by Edison International related to balancing account over-collections, the IRS issued a Notice of Proposed Adjustment in July 2007. This affirmative claim was addressed by the IRS as part of the ongoing IRS examinations and administrative appeals processes. The tax years to which adjustments are made pursuant to this Notice of Proposed Adjustment are included in the scope of the Global Settlement. The cash and earnings impacts of this position are dependent on the ultimate settlement of all open tax issues, including this issue, in these tax years. Edison International expects that resolution of this issue could potentially increase earnings and cash flows within the range of $70 million to $80 million and $300 million to $350 million, respectively.

*Contingent Liability Company*

The IRS has asserted deficiencies with respect to a transaction entered into by a former SCE subsidiary which may be considered substantially similar to a Listed Transaction described by the IRS as a contingent liability company for tax years 1997 and 1998. This issue is included in the Global Settlement and is being considered by the Administrative Appeals branch of the IRS where Edison International has been defending its income tax return position with respect to this transaction.

*Cross-Border Lease Transactions*

As part of a nationwide challenge of cross-border lease transactions, the IRS has asserted deficiencies related to Edison International s deferral of income taxes associated with certain of its cross-border, leveraged leases.

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These asserted deficiencies relate to Edison Capital s income tax treatment of both its foreign power plant and electric locomotive sale/leaseback transactions entered into in 1993 and 1994 (Replacement Leases, which the IRS refers to as sale-in/lease-out or SILOs) and its foreign power plants and electric transmission system lease/ leaseback transactions entered into in 1997 and 1998 (Lease/Leaseback, which the IRS refers to as lease-in/ lease-out or LILOs). For tax years 1994 1999, Edison International is challenging the asserted deficiencies in ongoing IRS appeals proceedings and as part of the Global Settlement.

In 1999, Edison Capital entered into a lease/service contract transaction involving a foreign telecommunication system (Service Contract, which the IRS refers to as a SILO). As part of an ongoing examination of 2000 2002, the IRS examination branch has been reviewing Edison International s income tax treatment of this Service Contract. The income tax treatment of the Service Contract is included in the Global Settlement for all tax years. The following table summarizes estimated federal and state income taxes deferred from these leases as of December 31, 2007. Repayment of the entire amount of the deferred income taxes, as provided in the table below, would be accelerated if Edison International and the IRS are unable to reach a settlement and the IRS position is to be sustained in litigation:

| | **Tax Years** | **Tax Years** | **Unaudited** | |
|---|---|---|---|---|
| | **Under Appeal** | **Under Audit** | **Tax Years** | |
| In millions | **1994 1999** | **2000 2006** | **2007** | **Total** |
| Replacement Leases (SILO) | $ 44 | $ 42 | $ 4 | $ 90 |
| Lease/Leaseback (LILO) | 563 | 572 | (14) | 1,121 |
| Service Contract (SILO) | | 326 | 54 | 380 |
| **Total** | $607 | $940 | $ 44 | $1,591 |

As of September 30, 2008, the after-tax interest on the proposed tax adjustments is estimated to be approximately $613 million. The IRS has also asserted a 20% penalty on any sustained adjustment (other than with respect to the Service Contract).

Edison International believes that its maximum earnings exposure related to these leases, measured as of September 30, 2008, is approximately $1.3 billion after taxes, calculated by reclassifying deferred income taxes to current, re-computing the cumulative earnings under the leases in accordance with lease accounting rules (FASB Staff Position FAS 13-2), and recording interest related to the current income tax liability. Interest will continue to accrue until settled. This exposure does not include IRS asserted penalties of 20%, as Edison International does not believe that even if the tax benefits taken by Edison Capital are successfully challenged by the IRS that these penalties would be sustained. The current and future earnings and cash positions of SCE and EME are virtually unaffected by these leases.

During the second quarter of 2008, there were court decisions involving income taxation of cross-border leveraged leases that were adverse to the taxpayers involved. These developments underscore the uncertain nature of tax conclusions in this area. Despite these developments, Edison International believes it properly reported these transactions based on applicable statutes, regulations and case law and, in the absence of any settlement with the IRS, will continue to vigorously defend its tax treatment of these leases. Edison International will continue to monitor and evaluate its lease transactions with respect to future events. Future adverse developments, including further adverse case law developments, could change Edison International s current conclusions.

As previously disclosed, Edison International is currently engaged in settlement negotiations with the IRS to reach a Global Settlement which, if consummated, would resolve cross-border, leveraged lease issues in their entirety and all other outstanding tax disputes for open tax years 1986 through 2002, including certain affirmative claims for unrecognized tax benefits. These negotiations have progressed to the point where Edison International and the IRS have reached nonbinding, preliminary understandings on the material principles for resolving the lease issues as part of the resolution of all issues included in the Global Settlement. Final resolution of such disputes, as part of the Global Settlement, is subject to reaching definitive agreements on final terms and calculations, mutually satisfactory documentation, and review of all or a portion of the Global Settlement by the

Staff of the Joint Committee on Taxation, a committee of the United States Congress (the Joint Committee ). While not assured, Edison International believes that the Global Settlement will be submitted or substantially ready to be submitted to the Joint Committee during the fourth quarter of 2008.

Edison International expects that the leases will be terminated in anticipation of the Global Settlement. Timing of termination is uncertain and could occur prior to the Joint Committee completing its work or otherwise prior to consummation of the settlement. Edison Capital and its subsidiaries have either reached agreement or are negotiating agreements based on executed term sheets with all of the counterparties to its SILOs and LILOs which contemplate termination of the leases subject to a final settlement agreement with the IRS. Certain of these agreements will not be binding on Edison Capital or the counterparties until such termination. Upon termination of the leases, the lessees would be required to make termination payments from certain collateral deposits associated with the leases, and Edison International would no longer recognize earnings from such leases.

If all settlements included in the Global Settlement discussions were ultimately concluded consistent with the preliminary understandings, Edison International would expect that the settlement of the disputed lease issues and the resolution of the above-mentioned affirmative claims would result in a portion of the charge initially recorded upon termination of the leases being offset and/or reduced, and the net after-tax earnings charge that would remain is currently expected to be less than half of the maximum after-tax earnings exposure, calculated as of September 30, 2008, discussed above. Accordingly, it is not anticipated that borrowings would be required in connection with implementation of the settlements. Termination of the leases prior to consummation of the settlements would result in Edison International initially recording an after-tax charge to earnings currently estimated to be at least $650 million (and potentially up to the maximum earnings exposure indicated above), which would be reduced and/or offset upon completion of the settlements.

There can be no assurance, however, about the timing of final settlements with the IRS or that such final settlements will be ultimately consummated. Moreover, review by the Joint Committee could result in adjustments to the Global Settlement reached between Edison International and the IRS. The IRS and Edison International may not reach final agreements that implement the preliminary understandings, or they may reach final agreements but conditions to consummating them may not be satisfied. If Edison International terminated the SILO and LILO leases without consummating the Global Settlement or any other settlement with the IRS, of the cross-border lease issues, then it could not seek through litigation with the IRS future deferred tax benefits that may have been otherwise available in the absence of termination.

To the extent that an acceptable settlement is not reached with the IRS, Edison International will continue to vigorously defend its tax treatment of the leases and is prepared to take legal action. If Edison International were to commence litigation in certain forums, it would need to make payments of the disputed taxes, along with interest and any penalties asserted by the IRS, and thereafter pursue refunds. In the United States Tax Court, the other litigation forum, no upfront payment would be required. In 2006, Edison International paid $111 million of the taxes, interest and penalties for tax year 1999 followed by a refund claim for the same amount. The IRS did not act on this refund claim within the statutory six month period, which provides Edison International with the option of being able to take legal action to assert its refund claim. To the extent an acceptable settlement is not reached with the IRS, Edison International, based on its preference for litigation forum, may file refund claims for any taxes, interest and penalties paid for tax years related to these leases. However, Edison International has not decided whether and to what extent it would make additional payments related to later tax years to fund its right to litigate in certain forums should the Global Settlement, or another settlement, not be consummated.

***Resolution of Federal and State Income Tax Issues Being Addressed in Ongoing Examinations, Administrative Appeals and the Global Settlement***

Edison International continues its efforts to resolve open tax issues through tax year 2002 as part of the Global Settlement. Although the timing for resolving these open tax positions is uncertain, it is reasonably possible that all or a significant portion of these open tax issues through tax year 2002 could be resolved within the next 12 months.

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**Note 4. Compensation and Benefits Plans**

***Pension Plans***

As of September 30, 2008, Edison International had made $16 million in contributions related to 2007 and $45 million related to 2008 and estimates to make $14 million of additional contributions in the last three months of 2008.

Volatile market conditions have affected the value of Edison International s trusts established to fund its future long-term pension benefits. The market value of the investments within the plan trusts declined 22% during the nine months ended September 30, 2008. These benefit plan assets and related obligations are remeasured annually using a December 31 measurement date. Unless the market recovers, reductions in the value of plan assets will result in increased future expense, a change in the pension plan funding status from overfunded to underfunded and increased future contributions. Changes in the plan s funded status will affect the assets and liabilities recorded on the balance sheet in accordance with SFAS No. 158. Due to SCE s regulatory recovery treatment, the recognition of the funded status is offset by regulatory liabilities and assets. In the 2009 GRC, SCE requested recovery of and continued balancing account treatment for amounts contributed to these trusts. The Pension Protection Act of 2006 establishes new minimum funding standards and prohibits plans underfunded by more than 20% from providing lump sum distributions and adopting amendments that increase plan liabilities.

Net pension cost recognized is calculated under the actuarial method used for ratemaking. The difference between pension costs calculated for accounting and ratemaking is deferred.

Expense components are:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| In millions | **2008** | 2007 | **2008** | 2007 |
| | | (Unaudited) | | |
| Service cost | **$ 32** | $ 31 | **$ 95** | $ 93 |
| Interest cost | **50** | 47 | **151** | 141 |
| Expected return on plan assets | **(65)** | (63) | **(197)** | (190) |
| Amortization of prior service cost | **4** | 4 | **13** | 12 |
| Amortization of net loss | | 1 | **1** | 4 |
| Expense under accounting standards | **21** | 20 | **63** | 60 |
| Regulatory adjustment deferred | | 1 | | 3 |
| **Total expense recognized** | **$ 21** | $ 21 | **$ 63** | $ 63 |

***Postretirement Benefits Other Than Pensions***

As of September 30, 2008, Edison International had made no contributions related to 2007 and $14 million related to 2008 and estimates to make $26 million of additional contributions in the last three months of 2008.

Volatile market conditions have affected the value of Edison International s trust established to fund its future other postretirement benefits. The market value of the investments within the plan trust declined 21% during the nine months ended September 30, 2008. These benefit plan assets and related obligations are remeasured annually using a December 31 measurement date. Unless the market recovers, reductions in the value of plan assets will result in increased future expense, an increase in the plan underfunded status and increased future contributions. Changes in the plan s funded status will affect the assets and liabilities recorded on the balance sheet in accordance with SFAS No. 158. Due to SCE s regulatory recovery treatment, the recognition of the funded status is offset by regulatory liabilities and assets. In the 2009 GRC, SCE requested recovery of and continued balancing account treatment for amounts contributed to this trust.

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Expense components are:

| In millions | Three Months Ended September 30, 2008 | Three Months Ended September 30, 2007 | Nine Months Ended September 30, 2008 | Nine Months Ended September 30, 2007 |
|---|---|---|---|---|
| | | (Unaudited) | | |
| Service cost | **$ 12** | $ 11 | **$ 36** | $ 33 |
| Interest cost | **35** | 32 | **105** | 96 |
| Expected return on plan assets | **(31)** | (30) | **(93)** | (90) |
| Amortization of prior service credit | **(8)** | (8) | **(24)** | (24) |
| Amortization of net loss | **4** | 7 | **12** | 21 |
| **Total expense recognized** | **$ 12** | $ 12 | **$ 36** | $ 36 |

***Stock-Based Compensation***

During the first quarter of 2008, Edison International granted its 2008 stock-based compensation awards, which included stock options, performance shares, deferred stock units and restricted stock units. Total stock-based compensation expense (reflected in the caption Other operation and maintenance on the consolidated statements of income) was $5 million and $9 million for the three months ended September 30, 2008 and 2007, respectively, and was $24 million and $38 million for the nine months ended September 30, 2008 and 2007, respectively. The income tax benefit recognized in the consolidated statements of income was $2 million and $4 million for the three months ended September 30, 2008 and 2007, respectively, and was $10 million and $15 million for the nine months ended September 30, 2008 and 2007, respectively. Total stock-based compensation cost capitalized was less than $1 million and $1 million for the three months ended September 30, 2008 and 2007, respectively, and was $2 million and $4 million for the nine months ended September 30, 2008 and 2007, respectively.

*Stock Options*

A summary of the status of Edison International stock options is as follows:

| | Stock Options | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| | | (Unaudited) | | |
| Outstanding at December 31, 2007 | 12,105,642 | $ 30.55 | | |
| Granted | 2,814,119 | $ 48.61 | | |
| Expired | (500) | $ 28.94 | | |
| Forfeited | (324,913) | $ 49.28 | | |
| Exercised | (881,690) | $ 25.82 | | |
| Outstanding at September 30, 2008 | 13,712,658 | $ 34.12 | 6.48 | |
| Vested and expected to vest at September 30, 2008 | 13,261,884 | $ 33.71 | 6.41 | $ 168,160,689 |
| Exercisable at September 30, 2008 | 8,214,131 | $ 26.60 | 5.27 | $ 162,557,652 |

Stock options granted in 2008 do not accrue dividend equivalents.

The amount of cash used to settle stock options exercised was $5 million and $12 million for the three months ended September 30, 2008 and 2007, respectively, and was $46 million and $174 million for the nine months ended September 30, 2008 and 2007, respectively. Cash received from options exercised was $3 million and

$5 million for the three months ended September 30, 2008 and 2007, respectively, and was $23 million and $77 million for the nine months ended September 30, 2008 and 2007, respectively. The estimated tax benefit from options exercised was $1 million and $3 million for the three months ended September 30, 2008 and 2007, respectively, and was $9 million and $39 million for the nine months ended September 30, 2008 and 2007, respectively.

**Note 5. Commitments and Contingencies**

The following is an update to Edison International s commitments and contingencies. See Note 6 of Notes to Consolidated Financial Statements included in Edison International s 2007 Annual Report on Form 10-K for a detailed discussion.

***Lease Commitments***

During the second quarter of 2008, SCE entered into power-purchase contracts which are classified as operating leases. The contract terms range from 10 to 20 years. The delivery of energy under one of these contracts is not expected to commence until 2018. These additional commitments are currently estimated to be: remainder of 2008 $4 million, 2009 $14 million, 2010 $15 million, 2011 $15 million, 2012 $15 million and thereafter $828 million.

During the third quarter of 2008, SCE entered into power-purchase contracts which are classified as capital leases. The contract terms are 20 years. The delivery of energy under these contracts is expected to commence in 2010. These additional commitments are currently estimated to be: 2010 $32 million, 2011 $119 million, 2012 $119 million and thereafter $2.6 billion. The estimated executory costs and interest expense associated with these additional commitments are $699 million and $988 million, respectively. The total additional estimated net commitments are $1.2 billion.

***Other Commitments***

During the first nine months of 2008, SCE entered into service contracts associated with uranium enrichment and fuel fabrication. As a result, SCE s additional fuel supply commitments are estimated to be: 2009 $51 million, 2010 $54 million, 2011 $98 million, 2012 $146 million and thereafter $671 million.

During the second quarter of 2008, SCE entered into a new power-purchase contract. The delivery of energy under this contract is expected to commence in August 2010 with a 10 year term. SCE s additional commitments upon commencement are estimated to be: 2010 $188 million, 2011 $335 million, 2012 $341 million and thereafter $2.7 billion.

At September 30, 2008, EME s subsidiaries had firm commitments to spend approximately $204 million during the remainder of 2008 and $42 million in 2009 on capital and construction expenditures. The majority of these expenditures relate to the construction of wind projects. These expenditures are planned to be financed by cash on hand and cash generated from operations.

EME had entered into various turbine supply agreements with vendors to support its wind and thermal development efforts. At September 30, 2008, EME had secured 484 wind turbines (942 MW) and 5 gas-fired turbines (479 MW) for use in future projects for an aggregate purchase price of $1.4 billion, with remaining commitments of $66 million in 2008, $794 million in 2009 and $260 million in 2010. At September 30, 2008, EME had recorded wind turbine deposits of $318 million included in other long-term assets on its consolidated balance sheet.

In connection with the acquisition of the Illinois Plants, Midwest Generation had assumed a long-term coal supply contract and recorded a liability to reflect the fair value of this contract. In March 2008, Midwest Generation entered into an agreement to buy-out its coal obligations for the years 2009 through 2012 under this

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contract with a one-time payment to be made in January 2009. Midwest Generation recorded a pre-tax gain of $15 million ($9 million, after tax) during the first quarter of 2008 reflected in (Gain) on buyout of contract and (gain)/loss on sale of assets on the consolidated statements of income. The remaining payments due under this contract are $15 million.

EME s subsidiaries had entered into contractual agreements during the first nine months of 2008 to purchase materials for environmental controls equipment. In addition, during the nine months ended September 30, 2008, EME s subsidiaries entered into turbine operations and maintenance agreements. These commitments are currently estimated to aggregate to $196 million, summarized as follows: remainder of 2008 $3 million, 2009 $31 million, 2010 $48 million, 2011 $48 million, 2012 $46 million, and thereafter $20 million.

***Guarantees and Indemnities***

Edison International s subsidiaries have various financial and performance guarantees and indemnifications which are issued in the normal course of business. As discussed below, these contracts included performance guarantees, guarantees of debt and indemnifications.

*Tax Indemnity Agreements*

In connection with the sale-leaseback transactions related to the Homer City facilities in Pennsylvania, the Powerton and Joliet Stations in Illinois and, previously, the Collins Station in Illinois, EME and several of its subsidiaries entered into tax indemnity agreements. Although the Collins Station lease terminated in April 2004, Midwest Generation s tax indemnity agreement with the former lease equity investor is still in effect. Under these tax indemnity agreements, these entities agreed to indemnify the lessors in the sale-leaseback transactions for specified adverse tax consequences that could result in certain situations set forth in each tax indemnity agreement, including specified defaults under the respective leases. The potential indemnity obligations under these tax indemnity agreements could be significant. Due to the nature of these potential obligations, EME cannot determine a maximum potential liability which would be triggered by a valid claim from the lessors. EME has not recorded a liability related to these indemnities.

*Indemnities Provided as Part of the Acquisition of the Illinois Plants*

In connection with the acquisition of the Illinois Plants, EME agreed to indemnify Commonwealth Edison with respect to specified environmental liabilities before and after December 15, 1999, the date of sale. The indemnification claims are reduced by any insurance proceeds and tax benefits related to such claims and are subject to a requirement that Commonwealth Edison takes all reasonable steps to mitigate losses related to any such indemnification claim. Due to the nature of the obligation under this indemnity, a maximum potential liability cannot be determined. This indemnification for environmental liabilities is not limited in term and would be triggered by a valid claim from Commonwealth Edison. By letter dated August 8, 2007, Commonwealth Edison advised EME that Commonwealth Edison believes it is entitled to indemnification for all liabilities, costs, and expenses that it may be required to bear as a result of the NOV discussed below under Contingencies Midwest Generation New Source Review Notice of Violation. By letter dated August 16, 2007, Commonwealth Edison tendered a request for indemnification to EME for all liabilities, costs, and expenses that Commonwealth Edison may be required to bear if the environmental groups were to file suit. Except as discussed below, EME has not recorded a liability related to this indemnity.

Midwest Generation entered into a supplemental agreement with Commonwealth Edison and Exelon Generation Company LLC on February 20, 2003 to resolve a dispute regarding interpretation of its reimbursement obligation for asbestos claims under the environmental indemnities set forth in the Asset Sale Agreement. Under this supplemental agreement, Midwest Generation agreed to reimburse Commonwealth Edison and Exelon Generation for 50% of specific asbestos claims pending as of February 2003 and related expenses less recovery of insurance costs, and agreed to a sharing arrangement for liabilities and expenses associated with future asbestos-related claims as specified in the agreement. As a general matter, Commonwealth Edison and Midwest

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Generation apportion responsibility for future asbestos-related claims based upon the number of exposure sites that are Commonwealth Edison locations or Midwest Generation locations. The obligations under this agreement are not subject to a maximum liability. The supplemental agreement had an initial five-year term with an automatic renewal provision for subsequent one-year terms (subject to the right of either party to terminate); pursuant to the automatic renewal provision, it has been extended until February 2009. Payments are made under this indemnity upon tender by Commonwealth Edison of appropriate proof of liability for an asbestos-related settlement, judgment, verdict, or expense. There were approximately 208 cases for which Midwest Generation was potentially liable and that had not been settled and dismissed at September 30, 2008. Midwest Generation had recorded a $53 million liability at September 30, 2008 related to this matter.

The amounts recorded by Midwest Generation for the asbestos-related liability are based upon a number of assumptions. Future events, such as the number of new claims to be filed each year, the average cost of disposing of claims, as well as the numerous uncertainties surrounding asbestos litigation in the United States, could cause the actual costs to be higher or lower than projected.

*Indemnity Provided as Part of the Acquisition of the Homer City Facilities*

In connection with the acquisition of the Homer City facilities, EME Homer City agreed to indemnify the sellers with respect to specific environmental liabilities before and after the date of sale. Payments would be triggered under this indemnity by a valid claim from the sellers. EME guaranteed the obligations of EME Homer City. Due to the nature of the obligation under this indemnity provision, it is not subject to a maximum potential liability and does not have an expiration date. EME has not recorded a liability related to this indemnity.

*Indemnities Provided under Asset Sale Agreements*

The asset sale agreements for the sale of EME s international assets contain indemnities from EME to the purchasers, including indemnification for taxes imposed with respect to operations of the assets prior to the sale and for pre-closing environmental liabilities. Not all indemnities under the asset sale agreements have specific expiration dates. Payments would be triggered under these indemnities by valid claims from the sellers or purchasers, as the case may be. At September 30, 2008, EME had recorded a liability of $97 million related to these matters.

In connection with the sale of various domestic assets, EME has from time to time provided indemnities to the purchasers for taxes imposed with respect to operations of the asset prior to the sale. EME has also provided indemnities to purchasers for items specified in each agreement (for example, specific pre-existing litigation matters and/or environmental conditions). Due to the nature of the obligations under these indemnity agreements, a maximum potential liability cannot be determined. Not all indemnities under the asset sale agreements have specific expiration dates. Payments would be triggered under these indemnities by valid claims from the sellers or purchasers, as the case may be. At September 30, 2008, EME had recorded a liability of $13 million related to these matters.

*Capacity Indemnification Agreements*

EME has guaranteed, jointly and severally with Texaco Inc., the obligations of March Point Cogeneration Company under its project power sales agreements to repay capacity payments to the project s power purchaser in the event that the power sales agreements terminate, March Point Cogeneration Company abandons the project, or the project fails to return to normal operations within a reasonable time after a complete or partial shutdown, during the term of the power sales agreements. The obligations under this indemnification agreement as of September 30, 2008, if payment were required, would be $63 million. EME has not recorded a liability related to this indemnity.

*Indemnity Provided as Part of the Acquisition of Mountainview*

In connection with the acquisition of Mountainview, SCE agreed to indemnify the seller with respect to specific environmental claims related to SCE s previously owned San Bernardino Generating Station, divested by SCE in 1998 and reacquired as part of the Mountainview acquisition. SCE retained certain responsibilities with respect to environmental claims as part of the original divestiture of the station. The aggregate liability for either party to the purchase agreement for damages and other amounts is a maximum of $60 million. This indemnification for environmental liabilities expires on or before March 12, 2033. SCE has not recorded a liability related to this indemnity.

*Mountainview Filter Cake Indemnity*

Mountainview owns and operates a power plant in Redlands, California. The plant utilizes water from on-site groundwater wells and City of Redlands (City) recycled water for cooling purposes. Unrelated to the operation of the plant, this water contains perchlorate. The pumping of the water removes perchlorate from the aquifer beneath the plant and concentrates it in the plant s wastewater treatment filter cake. Use of this impacted groundwater for cooling purposes was mandated by Mountainview s CEC permit. Mountainview has indemnified the City for cleanup or associated actions related to groundwater contaminated by perchlorate due to the disposal of filter cake at the City s solid waste landfill. The obligations under this agreement are not limited to a specific time period or subject to a maximum liability. SCE has not recorded a liability related to this guarantee.

*Other Edison International Indemnities*

Edison International provides other indemnifications through contracts entered into in the normal course of business. These are primarily indemnifications against adverse litigation outcomes in connection with underwriting agreements, and specified environmental indemnities and income taxes with respect to assets sold. Edison International s obligations under these agreements may be limited in terms of time and/or amount, and in some instances Edison International may have recourse against third parties for certain indemnities. The obligated amounts of these indemnifications often are not explicitly stated, and the overall maximum amount of the obligation under these indemnifications cannot be reasonably estimated. Edison International has not recorded a liability related to these indemnities.

***Contingencies***

In addition to the matters disclosed in these Notes, Edison International is involved in other legal, tax and regulatory proceedings before various courts and governmental agencies regarding matters arising in the ordinary course of business. Edison International believes the outcome of these other proceedings will not materially affect its consolidated results of operations or liquidity.

*Environmental Remediation*

Edison International is subject to numerous environmental laws and regulations, which require it to incur substantial costs to operate existing facilities, construct and operate new facilities, and mitigate or remove the effect of past operations on the environment.

Edison International believes that it is in substantial compliance with environmental regulatory requirements; however, possible future developments, such as the enactment of more stringent environmental laws and regulations, could affect the costs and the manner in which business is conducted and could cause substantial additional capital expenditures. There is no assurance that additional costs would be recovered from customers or that Edison International s consolidated financial position and results of operations would not be materially affected.

Edison International records its environmental remediation liabilities when site assessments and/or remedial actions are probable and a range of reasonably likely cleanup costs can be estimated. Edison International reviews its sites and measures the liability quarterly, by assessing a range of reasonably likely costs for each identified site using currently available information, including existing technology, presently enacted laws and regulations, experience gained at similar sites, and the probable level of involvement and financial condition of other potentially responsible parties. These estimates include costs for site investigations, remediation, operations and maintenance, monitoring and site closure. Unless there is a probable amount, Edison International records the lower end of this reasonably likely range of costs (classified as other long-term liabilities) at undiscounted amounts.

As of September 30, 2008, Edison International s recorded estimated minimum liability to remediate its 45 identified sites at SCE (24 sites) and EME (21 sites primarily related to Midwest Generation) was $50 million, $47 million of which was related to SCE including $14 million related to San Onofre. This remediation liability is undiscounted. Edison International s other subsidiaries have no identified remediation sites. The ultimate costs to clean up Edison International s identified sites may vary from its recorded liability due to numerous uncertainties inherent in the estimation process, such as: the extent and nature of contamination; the scarcity of reliable data for identified sites; the varying costs of alternative cleanup methods; developments resulting from investigatory studies; the possibility of identifying additional sites; and the time periods over which site remediation is expected to occur. Edison International believes that, due to these uncertainties, it is reasonably possible that cleanup costs could exceed its recorded liability by up to $167 million, all of which is related to SCE. The upper limit of this range of costs was estimated using assumptions least favorable to Edison International among a range of reasonably possible outcomes. In addition to its identified sites (sites in which the upper end of the range of costs is at least $1 million), SCE also has 30 immaterial sites whose total liability ranges from $3 million (the recorded minimum liability) to $9 million.

The CPUC allows SCE to recover environmental remediation costs at certain sites, representing $32 million of its recorded liability, through an incentive mechanism (SCE may request to include additional sites). Under this mechanism, SCE will recover 90% of cleanup costs through customer rates; shareholders fund the remaining 10%, with the opportunity to recover these costs from insurance carriers and other third parties. SCE has successfully settled insurance claims with all responsible carriers. SCE expects to recover costs incurred at its remaining sites through customer rates. SCE has recorded a regulatory asset of $42 million for its estimated minimum environmental-cleanup costs expected to be recovered through customer rates.

Edison International s identified sites include several sites for which there is a lack of currently available information, including the nature and magnitude of contamination, and the extent, if any, that Edison International may be held responsible for contributing to any costs incurred for remediating these sites. Thus, no reasonable estimate of cleanup costs can be made for these sites.

Edison International expects to clean up its identified sites over a period of up to 30 years. Remediation costs in each of the next several years are expected to range from $11 million to $31 million. Recorded costs for the 12 months ended September 30, 2008 were $32 million.

Based on currently available information, Edison International believes it is unlikely that it will incur amounts in excess of the upper limit of the estimated range for its identified sites and, based upon the CPUC s regulatory treatment of environmental remediation costs incurred at SCE, Edison International believes that costs ultimately recorded will not materially affect its consolidated results of operations or financial position. There can be no assurance, however, that future developments, including additional information about existing sites or the identification of new sites, will not require material revisions to such estimates.

*Federal and State Income Taxes*

As part of a nationwide challenge of certain types of lease transactions, the IRS has raised issues about the deferral of income taxes associated with certain lease and kind of lease transactions. See Note 3 for further details.

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*FERC Transmission Incentives*

On November 16, 2007, the FERC issued an order granting incentives on three of SCE s largest proposed transmission projects:

A 125 basis point ROE adder on SCE s future proposed base ROE ( ROE Adder ) for DPV2, which is a high voltage (500 kV) transmission line from the Valley substation to the Devers substation near Palm Springs, California to a new substation near Palo Verde, west of Phoenix, Arizona;

A 125 basis point ROE Adder for the Tehachapi Transmission Project, which is an eleven segment project consisting of newly-constructed and upgraded transmission lines and associated substations to interconnect renewable generation projects near the Tehachapi and Big Creek area; and

A 75 basis point ROE Adder for the Rancho Vista Substation Project, which is a new 500 kV substation in the City of Rancho Cucamonga. The order also grants a higher return on equity on SCE s entire transmission rate base in SCE s next FERC transmission rate case for SCE s participation in the CAISO. In September 2008, the FERC accepted SCE s revisions to its Transmission Owner Tariff, with a requested effective date of March 1, 2009 subject to refund and settlement procedures. In addition, the order permits SCE to include in rate base 100% of prudently-incurred capital expenditures during construction, also known as CWIP, of all three projects and 100% recovery of prudently-incurred abandoned plant costs for DPV2 and Tehachapi, if either or both of these projects are cancelled due to factors beyond SCE s control.

In June 2008, the FERC rejected petitions filed by certain parties, including the CPUC, to address the CAISO higher return and the ROE project adders. In August 2008, the CPUC filed an appeal of the FERC incentives order at the DC Circuit Court of Appeals.

*FERC Construction Work in Progress Mechanism*

On December 21, 2007, SCE filed a revision to its Transmission Owner Tariff to collect 100% of CWIP in rate base for its Tehachapi, DPV2, and Rancho Vista projects. In the CWIP filing, SCE proposed a rate adjustment ($45 million or a 14.4% increase) to SCE s currently authorized base transmission revenue requirement to be made effective on March 1, 2008 and later adjusted for amounts actually spent in 2008 through a new balancing account mechanism. The rate adjustment represents actual expenditures from September 1, 2005 through November 30, 2007, projected expenditures from December 1, 2007 through December 31, 2008, and a ROE (which includes the ROE adders approved for Tehachapi, DPV2 and Rancho Vista). The rate adjustment is based on a projection that SCE will spend a total of approximately $244 million, $27 million, and $181 million for Tehachapi, DPV2, and Rancho Vista, respectively, from September 1, 2005 through the end of 2008. The 2008 DPV2 expenditure forecast is limited to projected consulting and legal costs associated with SCE s continued efforts to obtain regulatory approvals necessary to construct the DPV2 Project. On February 29, 2008, the CWIP filing was approved and SCE implemented the CWIP rate on March 1, 2008, subject to refund on the limited issue of whether SCE s proposed ROEs are reasonable. On March 28, 2008, the CPUC filed a petition for rehearing with the FERC on the FERC s acceptance of SCE s proposed ROE for CWIP. Briefs addressing the appropriate ROE were filed by SCE and intervenors in May 2008. In addition, in the order, SCE was directed by FERC to make a compliance filing to provide greater detail on the costs reflected in CWIP rates for 2008. SCE made the compliance filing on March 31, 2008. On April 21, 2008, the CPUC filed a protest of the compliance filing at FERC and requested an evidentiary hearing to be set to further review the costs. SCE filed a response to the CPUC s protest on May 6, 2008 arguing that the FERC should deny the CPUC s request for a further hearing. SCE cannot predict the outcome of the matters in this proceeding.

SCE filed its 2009 update to its CWIP rate adjustment on October 31, 2008. SCE proposed a reduction to its CWIP revenue requirement from $45 million to $39 million to be effective on January 1, 2009.

*Investigation Regarding Performance Incentives Rewards*

SCE was eligible under the CPUC-approved PBR mechanism to earn rewards or incur penalties based on its performance in comparison to CPUC-approved standards of customer satisfaction, employee safety reporting, and system reliability. SCE conducted investigations into its performance under the PBR mechanism and reported to the CPUC certain findings of misconduct and misreporting related to the first two components of the PBR program. Following SCE s reporting, the CPUC opened its own investigation of SCE s activities relative to the PBR mechanism.

CPUC Decision

On September 18, 2008, the CPUC adopted a decision in the first phase of its investigation into SCE s incentives claimed under the CPUC-approved PBR mechanism that allowed SCE to earn rewards or incur penalties for the period 1997 2003 based on its performance in comparison to CPUC-approved standards of customer satisfaction and employee safety reporting. The adopted decision required SCE to refund $28 million and $20 million related to customer satisfaction and employee safety reporting incentives, respectively; and further required SCE to forego claimed incentives of $20 million and $15 million related to customer satisfaction and employee safety reporting, respectively. The decision also required SCE to refund $33 million for employee bonuses and imposed a statutory penalty of $30 million. During the third quarter, SCE recorded a charge of $49 million, after-tax, reflected primarily in Other nonoperating deductions in the consolidated statements of income related to this decision.

System Reliability

In light of the problems uncovered with the components of the PBR mechanism discussed above, SCE conducted an investigation into the third PBR standard, system reliability, for the years 1997 2003. SCE received $8 million in reliability incentive awards for the period 1997 2000 and had applied for a reward of $5 million for 2001. For 2002, SCE s data indicated that it earned no reward and incurred no penalty. For 2003, based on the application of the PBR mechanism, SCE determined that it would incur a penalty of $3 million and accrued a charge for that amount in 2004. On February 28, 2005, SCE provided its final investigation report to the CPUC concluding that the reliability reporting system was working as intended. System reliability incentives will be addressed in the second phase of the CPUC s investigation. SCE served its opening testimony in the second phase in September 2007. In that testimony, SCE presented evidence that its PBR system reliability results were valid. The schedule for the second phase of the investigation has been deferred until November 21, 2008. SCE cannot predict the outcome of the second phase but does not expect a material financial statement impact.

*EME Homer City New Source Review Notice of Violation*

On June 12, 2008, EME Homer City received an NOV from the US EPA alleging that, beginning in 1988, EME Homer City (or former owners of the Homer City facilities) performed repair or replacement projects at Homer City Units 1 and 2 without first obtaining construction permits as required by the Prevention of Significant Deterioration requirements of the Clean Air Act. The US EPA also alleges that EME Homer City has failed to file timely and complete Title V permits. EME Homer City has met with the US EPA and has expressed its intent to explore the possibility of a settlement. If no settlement is reached and the DOJ files suit, litigation could take many years to resolve the issues alleged in the NOV. EME Homer City is investigating the NOV claims and is developing a litigation strategy. EME Homer City cannot predict at this time what effect this matter may have on its facilities, its results of operations, financial position or cash flows. EME Homer City has sought indemnification for liability and defense costs associated with the NOV from the sellers under the asset purchase agreement pursuant to which EME Homer City acquired the Homer City facilities. The sellers responded by denying the indemnity obligation, but accepting the defense of the claims.

EME Homer City notified the sale-leaseback owner participants of the Homer City facilities of the NOV under the operative indemnity provisions of the sale-leaseback documents. The owner participants of the Homer City facilities, in turn, have sought indemnification and defense from EME Homer City for costs and liability

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associated with the EME Homer City NOV. EME Homer City responded by undertaking the indemnity obligation and defense of the claims.

*Four Corners CPUC Emissions Performance Standard Ruling*

The CPUC adopted a GHG emission performance standard, effective January 2007. In January 2008, SCE filed a petition with the CPUC seeking clarification that the emission performance standard would not apply to capital expenditures required by existing agreements among the owners at Four Corners. The CPUC issued a proposed decision finding that the emission performance standard was not intended to apply to capital expenditures at Four Corners requested by SCE in its General Rate Case for the period 2007 2011. On October 23, 2008, the Assigned Commissioner and Administrative Law Judge issued a ruling withdrawing the proposed decision and seeking additional comment on whether the finding in the proposed decision should be changed and whether SCE should be allowed to recover such capital expenditures. SCE estimates that its share of capital expenditures approved by the owners at Four Corners since the GHG emission performance standard decision was issued in January 2007 is approximately $43 million, of which approximately $8 million had been expended through September 30, 2008. The ruling also directs SCE to explain why certain information was not included in its petition and why the failure to include such information should not be considered misleading in violation of CPUC rules. SCE cannot predict the outcome of this proceeding or estimate the amount, if any, of penalties or disallowances that may be imposed.

*ISO Disputed Charges*

On April 20, 2004, the FERC issued an order concerning a dispute between the ISO and the Cities of Anaheim, Azusa, Banning, Colton and Riverside, California over the proper allocation and characterization of certain transmission service related charges. The order reversed an arbitrator s award that had affirmed the ISO s characterization in May 2000 of the charges as Intra-Zonal Congestion costs and allocation of those charges to scheduling coordinators in the affected zone within the ISO transmission grid. The April 20, 2004 order directed the ISO to shift the costs from scheduling coordinators in the affected zone to the responsible participating transmission owner, SCE. The potential cost to SCE, net of amounts SCE expects to receive through the PX, SCE s scheduling coordinator at the time, is estimated to be approximately $20 million to $25 million, including interest. On April 20, 2005, the FERC stayed its April 20, 2004 order during the pendency of SCE s appeal filed with the Court of Appeals for the D.C. Circuit. On March 7, 2006, the Court of Appeals remanded the case back to the FERC at the FERC s request and with SCE s consent. On March 29, 2007, the FERC issued an order agreeing with SCE s position that the charges incurred by the ISO were related to voltage support and should be allocated to the scheduling coordinators, rather than to SCE as a transmission owner. The Cities filed a request for rehearing of the FERC s order on April 27, 2007. On May 25, 2007, the FERC issued a procedural order granting the rehearing application for the limited purpose of allowing the FERC to give it further consideration. In a future order, FERC may deny the rehearing request or grant the requested relief in whole or in part. SCE believes that the most recent substantive FERC order correctly allocates responsibility for these ISO charges. However, SCE cannot predict the final outcome of the rehearing. If a subsequent regulatory decision changes the allocation of responsibility for these charges, and SCE is required to pay these charges as a transmission owner, SCE may seek recovery in its reliability service rates. SCE cannot predict whether recovery of these charges in its reliability service rates would be permitted.

*Leveraged Lease Investments*

At September 30, 2008, Edison Capital had a net leveraged lease investment, before deferred taxes, of $53 million in three aircraft leased to American Airlines. American Airlines reported net losses for its first, second and third quarters in 2008 and previously reported losses for a number of years prior to 2006. A default in the leveraged lease by American Airlines could result in a loss of some or all of Edison Capital s lease investment. At September 30, 2008, American Airlines was current in its lease payments to Edison Capital.

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*Midway-Sunset Cogeneration Company*

San Joaquin Energy Company, a wholly owned subsidiary of EME, owns a 50% general partnership interest in Midway-Sunset, which owns a 225 MW cogeneration facility near Fellows, California. Midway-Sunset is a party to several proceedings pending at the FERC because Midway-Sunset was a seller in the PX market during 2000 and 2001, both for its own account and on behalf of SCE and PG&E, the utilities to which the majority of Midway-Sunset s power was contracted for sale. As a seller into the PX market, Midway-Sunset is potentially liable for refunds to purchasers in these markets.

On December 20, 2007, Midway-Sunset entered into a settlement agreement in the amount of $86 million (including interest) with SCE, PG&E, SDG&E and certain California state parties to resolve Midway-Sunset s liability in the FERC refund proceedings. Midway-Sunset concurrently entered into a separate agreement with SCE and PG&E that provides for pro-rata reimbursement to Midway-Sunset by the two utilities of the portions of the agreed to refunds that are attributable to sales made by Midway-Sunset for the benefit of the utilities (Midway-Sunset did not retain any proceeds from power sold into the PX market on behalf of SCE and PG&E in excess of the amounts to which it was entitled under the pre-existing power sales contracts, but instead passed through those proceeds to the utilities). The settlement, which had been approved previously by the CPUC, was approved by the FERC on April 2, 2008.

During the period in which Midway-Sunset s generation was sold into the PX market, amounts SCE received from Midway-Sunset for its pro-rata share of such sales were credited to SCE s customers against power purchase expenses through the ratemaking mechanism in place at that time. During the second quarter of 2008, SCE reimbursed Midway-Sunset for its pro-rata share of the Midway-Sunset liability in the amount of approximately $43 million. In addition, SCE, as party to the Midway-Sunset settlement agreement, received a $20 million generator refund. The amount reimbursed to and received from Midway-Sunset (net amount of $23 million) were charged/refunded to ratepayers through regulatory mechanisms. SCE s reimbursement to Midway-Sunset and the refund payment received from Midway-Sunset did not impact earnings.

*Midwest Generation New Source Review Notice of Violation*

On August 3, 2007, Midwest Generation received an NOV from the US EPA alleging that, beginning in the early 1990s and into 2003, Midwest Generation or Commonwealth Edison performed repair or replacement projects at six Illinois coal-fired electric generating stations in violation of the Prevention of Significant Deterioration requirements and of the New Source Performance Standards of the Clean Air Act, including alleged requirements to obtain a construction permit and to install best available control technology at the time of the projects. The US EPA also alleges that Midwest Generation and Commonwealth Edison violated certain operating permit requirements under Title V of the Clean Air Act. Finally, the US EPA alleges violations of certain opacity and particulate matter standards at the Illinois Plants. The NOV does not specify the penalties or other relief that the US EPA seeks for the alleged violations. Midwest Generation, Commonwealth Edison, the US EPA, and the DOJ are in talks designed to explore the possibility of a settlement. If the settlement talks fail and the DOJ files suit, litigation could take many years to resolve the issues alleged in the NOV. As a result, Midwest Generation is investigating the claims made by the US EPA in the NOV and is developing a litigation strategy. Midwest Generation cannot predict the outcome of this matter or estimate the impact on its facilities, its results of operations, financial position or cash flows.

On August 13, 2007, Midwest Generation and Commonwealth Edison received a letter signed by several Chicago-based environmental action groups stating that, in light of the NOV, the groups are examining the possibility of filing a citizen suit against Midwest Generation and Commonwealth Edison based presumably on the same or similar theories advanced by the US EPA in the NOV.

By letter dated August 8, 2007, Commonwealth Edison advised EME that Commonwealth Edison believes it is entitled to indemnification for all liabilities, costs, and expenses that it may be required to bear as a result of the NOV. By letter dated August 16, 2007, Commonwealth Edison tendered a request for indemnification to EME for all liabilities, costs, and expenses that Commonwealth Edison may be required to bear if the environmental groups were to file suit. Midwest Generation and Commonwealth Edison are cooperating with one another in responding to the NOV.

*Navajo Nation Litigation*

The Navajo Nation filed a complaint in June 1999 in the D.C. District Court against SCE, among other defendants, arising out of the coal supply agreement for Mohave. The complaint asserts claims for, among other things, violations of the federal RICO statute, interference with fiduciary duties and contractual relations, fraudulent misrepresentations by nondisclosure, and various contract-related claims. The complaint claims that the defendants actions prevented the Navajo Nation from obtaining the full value in royalty rates for the coal supplied to Mohave. The complaint seeks damages of not less than $600 million, trebling of that amount, and punitive damages of not less than $1 billion. In March 2001, the Hopi Tribe was permitted to intervene as an additional plaintiff but has not yet identified a specific amount of damages claimed.

In April 2004, the D.C. District Court denied SCE s motion for summary judgment and concluded that a 2003 U.S. Supreme Court decision in an on-going related lawsuit by the Navajo Nation against the U.S. Government did not preclude the Navajo Nation from pursuing its RICO and intentional tort claims. In September 2007, the Federal Circuit reversed a lower court decision on remand in the related lawsuit, finding that the U.S. Government had breached its trust obligation in connection with the setting of the royalty rate for the coal supplied to Mohave. Subsequently, the Federal Circuit denied the U.S. Government s petition for rehearing. On October 1, 2008, the U.S. Supreme Court granted the U.S. Government s petition seeking review of the Federal Circuit s September 2007 decision. A decision from the U.S. Supreme Court is expected in mid-2009.

Pursuant to a joint request of the parties, the D.C. District Court granted a stay of the action in October 2004 to allow the parties to attempt to negotiate a resolution of the issues associated with Mohave with the assistance of a facilitator. In a joint status report filed on November 9, 2007, the parties informed the court that their mediation efforts had terminated and subsequently filed a joint motion to lift the stay. The parties have also filed recommendations for a scheduling order to govern the anticipated resumption of litigation. The Court granted the motion to lift the stay on March 6, 2008, reinstating the case to the active calendar, but has deferred setting an overall schedule for the action pending a determination of disputes concerning the discoverability of certain Navajo documents. SCE cannot predict the outcome of the Navajo Nation s and Hopi Tribe s complaints against SCE or the ultimate impact on these complaints of the Supreme Court s 2003 decision and the on-going litigation by the Navajo Nation against the U.S. Government in the related case.

*Nuclear Insurance*

Federal law limits public liability claims from a nuclear incident to the amount of available financial protection, which is currently approximately $12.5 billion. SCE and other owners of San Onofre and Palo Verde have purchased the maximum private primary insurance available ($300 million). The balance is covered by the industry s retrospective rating plan that uses deferred premium charges to every reactor licensee if a nuclear incident at any licensed reactor in the United States results in claims and/or costs which exceed the primary insurance at that plant site.

Federal regulations require this secondary level of financial protection. The NRC exempted San Onofre Unit 1 from this secondary level, effective June 1994. Beginning October 29, 2008, the maximum deferred premium for each nuclear incident is approximately $118 million per reactor, but not more than approximately $18 million per reactor may be charged in any one year for each incident. The maximum deferred premium per reactor and the yearly assessment per reactor for each nuclear incident will be adjusted for inflation at least once every five years beginning August 20, 2003. The most recent inflation adjustment took effect on October 29, 2008. Based on its ownership interests, SCE could be required to pay a maximum of approximately $235 million per nuclear incident. However, it would have to pay no more than approximately $35 million per incident in any one year.

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Such amounts include a 5% surcharge if additional funds are needed to satisfy public liability claims and are subject to adjustment for inflation. If the public liability limit above is insufficient, federal law contemplates that additional funds may be appropriated by Congress. This could include an additional assessment on all licensed reactor operators as a measure for raising further revenue.

Property damage insurance covers losses up to $500 million, including decontamination costs, at San Onofre and Palo Verde. Decontamination liability and property damage coverage exceeding the primary $500 million also has been purchased in amounts greater than federal requirements. Additional insurance covers part of replacement power expenses during an accident-related nuclear unit outage. A mutual insurance company owned by utilities with nuclear facilities issues these policies. If losses at any nuclear facility covered by the arrangement were to exceed the accumulated funds for these insurance programs, SCE could be assessed retrospective premium adjustments of up to approximately $45 million per year. Insurance premiums are charged to operating expense.

*Palo Verde Nuclear Generating Station Inspections*

The NRC held three special inspections of Palo Verde, between March 2005 and February 2007. The combination of the results of the first and third special inspections caused the NRC to undertake an additional oversight inspection of Palo Verde. This additional inspection, known as a supplemental inspection, was completed in December 2007. In addition, Palo Verde was required to take additional corrective actions based on the outcome of completed surveys of its plant personnel and self-assessments of its programs and procedures. The NRC and APS defined and agreed to inspection and survey corrective actions that the NRC embodied in a Confirmatory Action Letter, which was issued in February 2008. APS is presently on track to complete the corrective actions required to close the Confirmatory Action Letter by mid-2009. Palo Verde operation and maintenance costs (including overhead) increased in 2007 by approximately $7 million from 2006. SCE estimates that operation and maintenance costs will increase by approximately $23 million (in 2007 dollars) over the two year period 2008 2009, from 2007 recorded costs including overhead costs. SCE is unable to estimate how long SCE will continue to incur these costs. In the 2009 GRC, SCE requested recovery of, and two-way balancing account treatment for, Palo Verde operation and maintenance expenses including costs associated with these corrective actions. If approved, this would provide for recovery of these costs over the three-year GRC cycle.

*Procurement of Renewable Resources*

California law requires SCE to increase its procurement of renewable resources by at least 1% of its annual retail electricity sales per year so that 20% of its annual electricity sales are procured from renewable resources by no later than December 31, 2010.

SCE filed its latest compliance report in August 2008. Through the use of flexible compliance rules, SCE demonstrated full compliance for the procurement year 2007 and forecasted full compliance for the procurement years 2008 to 2020. It is unlikely that SCE will have 20% of its annual electricity sales procured from renewable resources by 2010. However, SCE may still meet the 20% target by utilizing the flexible compliance rules. SCE continues to engage in several renewable procurement activities including formal solicitations approved by the CPUC, bilateral negotiations with individual projects and other initiatives.

Under current CPUC decisions, potential penalties for SCE s inability to achieve its renewable procurement objectives for any year will be considered by the CPUC in the context of the CPUC s review of SCE s annual compliance filing. Under the CPUC s current rules, the maximum penalty for failing to achieve renewable procurement targets is $25 million per year. SCE cannot predict whether it will be assessed penalties.

*RPM Buyers Complaint*

On May 30, 2008, a group of entities referring to themselves as the RPM Buyers filed a complaint at the FERC asking that PJM s RPM, as implemented through the transitional base residual auctions establishing capacity payments for the period from June 1, 2008 through May 31, 2011, be found to have produced unjust and unreasonable capacity prices. The RPM Buyers alleged that the absence of price discipline provided by new capacity resources, together with the ability of existing resources to withhold some capacity within the RPM rules, produced capacity prices in the transition period that are not comparable to those that would have been produced in a competitive market or determined under cost-based regulation, and have requested that the FERC order refunds based on that difference.

On July 10, 2008, EME responded to the RPM Buyers complaint asking that it be dismissed based upon various legal precedents. A number of other parties, including PJM, also responded to the RPM Buyers complaint asking that it be dismissed. On September 19, 2008, the FERC dismissed the RPM Buyers complaint, finding that the RPM Buyers had failed to allege or prove that any party violated PJM s tariff and market rules, and that the prices determined during the transition period were determined in accordance with PJM s FERC-approved tariff. On October 20, 2008, the RPM Buyers requested rehearing of the FERC s order dismissing their complaint. This matter is currently pending before the FERC. EME cannot predict the outcome of this matter.

*Scheduling Coordinator Tariff Dispute*

Pursuant to the Amended and Restated Exchange Agreement, SCE serves as a scheduling coordinator for the DWP over the ISO-controlled grid. In late 2003, SCE began charging the DWP under a tariff subject to refund for FERC-authorized scheduling coordinator and line loss charges incurred by SCE on the DWP s behalf. The scheduling coordinator charges had been billed to the DWP under a FERC tariff that was subject to dispute. The DWP has paid the amounts billed under protest but requested that the FERC declare that SCE was obligated to serve as the DWP s scheduling coordinator without charge. The FERC accepted SCE s tariff for filing, but held that the rates charged to the DWP have not been shown to be just and reasonable and thus made them subject to refund and further review by the FERC.

In January 2008, an agreement between SCE and the DWP was executed settling the dispute discussed above. The settlement had been previously approved by the FERC in July 2007. The settlement agreement provides that the DWP will be responsible for line losses and SCE would be responsible for the scheduling coordinator charges. During the fourth quarter of 2007, SCE reversed and recognized in earnings (under the caption Purchased power in the consolidated statements of income) $30 million of an accrued liability representing line losses previously collected from the DWP that were subject to refund. As of December 31, 2007, SCE had an accrued liability of approximately $22 million (including $3 million of interest) representing the estimated amount SCE will refund for scheduling coordinator charges previously collected from the DWP. SCE made its first refund payment on February 20, 2008 and the second refund payment was made on February 27, 2008. SCE previously received FERC approval to recover the scheduling coordinator charges from all transmission grid customers through SCE s transmission rates and on December 11, 2007, the FERC accepted SCE s proposed transmission rates reflecting the forecast levels of costs associated with the settlement. Upon signing of the agreement in January 2008, SCE recorded a regulatory asset and recognized in earnings the amount of scheduling coordinator charges to be collected through rates. On July 8, 2008, the FERC approved SCE s refund report.

*Spent Nuclear Fuel*

Under federal law, the DOE is responsible for the selection and construction of a facility for the permanent disposal of spent nuclear fuel and high-level radioactive waste. The DOE did not meet its obligation to begin acceptance of spent nuclear fuel not later than January 31, 1998. It is not certain when the DOE will begin accepting spent nuclear fuel from San Onofre or other nuclear power plants. Extended delays by the DOE have led to the construction of costly alternatives and associated siting and environmental issues. SCE has paid the

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DOE the required one-time fee applicable to nuclear generation at San Onofre through April 6, 1983 (approximately $24 million, plus interest). SCE is also paying the required quarterly fee equal to 0.1¢ per-kWh of nuclear-generated electricity sold after April 6, 1983. On January 29, 2004, SCE, as operating agent, filed a complaint against the DOE in the United States Court of Federal Claims seeking damages for the DOE s failure to meet its obligation to begin accepting spent nuclear fuel from San Onofre. The case was stayed through April 7, 2006, when SCE and the DOE filed a Joint Status Report in which SCE sought to lift the stay and the government opposed lifting the stay. On June 5, 2006, the Court of Federal Claims lifted the stay on SCE s case and established a discovery schedule. In a Joint Status Report filed on July 1, 2008, the parties requested a trial date in mid-November 2008. On August 6, 2008, the Court set a trial date of April 14 28, 2009.

SCE has primary responsibility for the interim storage of spent nuclear fuel generated at San Onofre. Spent nuclear fuel is stored in the San Onofre Units 2 and 3 spent fuel pools and the San Onofre independent spent fuel storage installation where all of Unit 1 s spent fuel located at San Onofre and some of Unit 2 and 3 s spent fuel is stored. SCE, as operating agent, plans to transfer fuel from the Unit 2 and 3 spent fuel pools to the independent storage installation on an as-needed basis to maintain full core off-load capability for Units 2 and 3. There are now sufficient dry casks and modules available at the independent spent fuel storage installation to meet plant requirements through the end of 2008. SCE plans to add storage capacity incrementally to meet the plant requirements until 2022 (the end of the current NRC operating license).

In order to increase on-site storage capacity and maintain core off-load capability, Palo Verde has constructed an independent spent fuel storage facility. APS, as operating agent, plans to add storage capacity incrementally to maintain full core off-load capability for all three units.

**Note 6. Accumulated Other Comprehensive Income (Loss) Information**

Edison International s accumulated other comprehensive income (loss) consists of:

| In millions | Unrealized Gain (Loss) on Cash Flow Hedges | Foreign Currency Translation Adjustment | Pension and PBOP Net Loss | Pension and PBOP Prior Service Cost | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|---|---|
| | | | (Unaudited) | | |
| Balance at December 31, 2007 | $ (60) | $ (1) | $ (34) | $ 3 | $ (92) |
| Current period change | 150 | (4) | | | 146 |
| **Balance at September 30, 2008** | **$ 90** | **$ (5)** | **$ (34)** | **$ 3** | **$ 54** |

Unrealized gains on cash flow hedges, net of tax, at September 30, 2008, included unrealized gains on commodity hedges related to Midwest Generation and EME Homer City futures and forward electricity contracts that qualify for hedge accounting. These gains arise because current forecasts of future electricity prices in these markets are lower than the contract prices. As EME s hedged positions for continuing operations are realized, $46 million, after tax, of the net unrealized gains on cash flow hedges at September 30, 2008 are expected to be reclassified into earnings during the next 12 months. Management expects that reclassification of net unrealized gains will increase energy revenue recognized at market prices. Actual amounts ultimately reclassified into earnings over the next 12 months could vary materially from this estimated amount as a result of changes in market conditions. The maximum period over which a cash flow hedge is designated is through December 31, 2011.

Under SFAS No. 133, the portion of a cash flow hedge that does not offset the change in value of the transaction being hedged, which is commonly referred to as the ineffective portion, is immediately recognized in earnings. EME recorded net gains (losses) of $23 million and $(13) million during the third quarters of 2008 and 2007, respectively, and $(8) million and $(23) million during the nine months ended September 30, 2008 and 2007,

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respectively, representing the amount of cash flow hedges ineffectiveness for continuing operations, reflected in operating revenues on Edison International s consolidated income statements.

On September 15, 2008, Lehman Brothers Holdings filed for protection under Chapter 11 of the U.S. Bankruptcy Code. EME had power contracts with Lehman Brothers Commodity Services, Inc., a subsidiary of Lehman Brothers Holdings, for Midwest Generation for 2009 and 2010. The obligations of Lehman Brothers Commodity Services under the power contracts are guaranteed by Lehman Brothers Holdings. These contracts qualified as cash flow hedges under SFAS No. 133 until EME designated the power contracts as such, effective September 12, 2008 when it determined that it was no longer probable that performance would occur. The amount recorded in accumulated comprehensive income (loss) related to the effective portion of the hedges was $24 million pre-tax ($15 million, after tax) on this date. Since the power contracts are no longer being accounted for as cash flow hedges under SFAS No. 133, the subsequent change in fair value was recorded as an unrealized loss during the third quarter of 2008 reflected in operating revenues on EME s consolidated statement of income. Under SFAS No. 133, the pre-tax amount recorded in accumulated other comprehensive income (loss) will be reclassified to operating revenues based on the original forecasted transactions in 2009 ($15 million) and 2010 ($9 million), unless it becomes probable that forecasted transactions will no longer occur.

**Note 7. Supplemental Cash Flows Information**

Edison International s supplemental cash flows information is:

| In millions | Nine Months Ended September 30, 2008 | 2007 |
|---|---|---|
| | (Unaudited) | |
| **Cash payments (receipts) for interest and taxes:** | | |
| Interest net of amounts capitalized | **$ 532** | $ 466 |
| Tax payments (receipts) | **273** | (2) |
| **Noncash investing and financing activities:** | | |
| Details of obligation under capital lease: | | |
| Capital lease asset purchased | **$** | $ (10) |
| Capital lease obligation issued | | 10 |
| Dividends declared but not paid: | | |
| Common stock | **$ 99** | $ 94 |
| Preferred and preference stock of utility not subject to mandatory redemption | **13** | 8 |
| Details of assets acquired: | | |
| Fair value of assets acquired | **$** | $ 41 |

In connection with certain wind projects acquired during the second quarter of 2008 and the first and third quarters of 2007, the purchase price included payments that were due upon the start and/or completion of construction. Accordingly, during the first nine months of 2008 and 2007, EME accrued for estimated payments that were due upon commencement of construction and/or completion of construction scheduled during 2008 through 2009.

**Note 8. Fair Value Measurements**

SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (referred to as an exit price in SFAS No. 157). SFAS No. 157 clarifies that a fair value measurement for a liability should reflect the entity s non-performance risk. In addition, SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted

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market prices in active markets for identical assets and liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under SFAS No. 157 are:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities;

Level 2 Pricing inputs include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and

Level 3 Prices or valuations that require inputs that are both significant to the fair value measurements and unobservable.

Edison International s assets and liabilities carried at fair value primarily consist of derivative contracts, SCE nuclear decommissioning trust investments and money market funds. Derivative contracts primarily relate to power and gas and include contracts for forward physical sales and purchases, options and forward price swaps which settle only on a financial basis (including futures contracts). Derivative contracts can be exchange traded or over-the-counter traded.

The fair value of derivative contracts takes into account quoted market prices, time value of money, volatility of the underlying commodities and other factors. Derivatives that are exchange traded in active markets for identical assets or liabilities are classified as Level 1. The majority of EME s derivative contracts used for hedging purposes are based on forward market prices in active markets (PJM West Hub, Northern Illinois Hub and AEP/Dayton) adjusted for non-performance risks. EME obtains forward market prices from traded exchanges (ICE Futures U.S. or New York Mercantile Exchange) and available broker quotes. Then, EME selects a primary source that best represents traded activity for each market to develop observable forward market prices in determining fair value of these positions. Broker quotes or prices from exchanges are used to validate and corroborate the primary source. Broker quotes are considered observable when corroborated with prices from exchanges. The majority of the fair value of EME s derivative contracts determined in this manner are classified as Level 2. SCE s Level 2 derivatives primarily consist of natural gas swaps and natural gas physical trades for which SCE obtains the applicable Henry Hub and basis forward market prices from the New York Mercantile Exchange.

Level 3 includes the majority of SCE s derivatives, including over-the-counter options, bilateral contracts, and capacity and QF contracts. The fair value of these SCE derivatives is determined using uncorroborated broker quotes and models which may require SCE to extrapolate short-term observable inputs in order to calculate fair value. Level 3 also includes derivatives that trade infrequently (such as financial transmission rights, firm transmission rights and CRRs in the California market and over-the-counter derivatives at illiquid locations), derivatives with counterparties that have significant non-performance risks, as discussed below, and long-term power agreements. For illiquid financial transmission rights, firm transmission rights and CRRs, Edison International reviews objective criteria related to system congestion on a quarterly basis and other underlying drivers and adjusts fair value when Edison International concludes a change in objective criteria would result in a new valuation that better reflects the fair value. Changes in fair values are based on the hypothetical sale of illiquid positions. For illiquid long-term power agreements, fair value is based upon a discounting of future electricity prices derived from a proprietary model using the risk free discount rate for a similar duration contract, adjusted for credit risk and market liquidity. Changes in fair value are based on changes to forward market prices, including forecasted prices for illiquid forward periods. In circumstances where Edison International cannot verify fair value with observable market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value. As markets continue to develop and more pricing information becomes available, Edison International continues to assess valuation methodologies used to determine fair value.

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In assessing non-performance risks, EME reviews credit ratings of counterparties (and related default rates based on such credit ratings) and prices of credit default swaps. The market price (or premium) for credit default swaps represents the price that a counterparty would pay to transfer the risk of default, typically bankruptcy, to another party. A credit default swap is not directly comparable to the credit risks of derivative contracts, but provides market information of the related risk of non-performance. In light of recent market events, EME utilized market prices for credit default swaps in reducing the fair value of derivative assets with financial institutions by $7 million at September 30, 2008.

Investments in money market funds are generally classified as Level 1 as fair value is determined by observable market prices (unadjusted) in active markets. At September 30, 2008, EME has invested $20 million in the Reserve Primary Fund (a money market fund). The Reserve incurred a loss related to debt securities of Lehman Brothers Holdings and has announced liquidation of the Reserve with the latest valuation of $0.97 per share. EME has reduced the fair value of the investment by $1 million and transferred the remaining balance into Level 3 as observable market prices are not available.

The SCE nuclear decommissioning trust investments include equity securities, U.S. treasury securities and other fixed-income securities. Equity and treasury securities are classified as Level 1 as fair value is determined by observable market prices in active or highly liquid and transparent markets. The remaining fixed-income securities are classified as Level 2. The fair value of these financial instruments is based on evaluated prices that reflect significant observable market information such as reported trades, actual trade information of similar securities, benchmark yields, broker/dealer quotes, issuer spreads, bids, offers and relevant credit information.

The following table sets forth financial assets and liabilities that were accounted for at fair value as of September 30, 2008 by level within the fair value hierarchy.

| In millions | Level 1 | Level 2 | Level 3 | Netting and Collateral[1] | Total at September 30, 2008 |
|---|---|---|---|---|---|
| | | (Unaudited) | | | |
| Assets at Fair Value | | | | | |
| Money market funds[2] | $ 2,705 | $ | $ 19 | $ | $ 2,724 |
| Derivative contracts | 2 | 141 | 282 | | 425 |
| Nuclear decommissioning trusts[3] | 1,855 | 999 | | | 2,854 |
| Long-term disability plan | | 9 | | | 9 |
| Total assets[4] | 4,562 | 1,149 | 301 | | 6,012 |
| Liabilities at Fair Value | | | | | |
| Derivative contracts | (2) | (190) | (120) | 98 | (214) |
| **Net assets** | **$ 4,560** | **$ 959** | **$ 181** | **$ 98** | **$ 5,798** |

(1) Represents cash collateral and the impact of netting across the levels of the fair value hierarchy. Netting among positions classified within the same level is included in that level.

(2) Included in cash and cash equivalents and short-term investments on Edison International s consolidated balance sheet.

(3) Excludes net assets of $1 million for interest and dividend receivables and receivables related to pending securities sales and payables related to pending securities purchases.

(4) Excludes $32 million of cash surrender value of life insurance investments for deferred compensation.

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The following table sets forth a summary of changes in the fair value of Level 3 derivative contracts, net for the three- and nine-month periods ended September 30, 2008.

| | Three Months Ended September 30, | Nine Months Ended September 30, |
|---|---|---|
| In millions | 2008 | 2008 |
| | (Unaudited) | |
| Fair value of derivative contracts, net at beginning of period | $ 386 | $ 98 |
| Total realized/unrealized gains (losses): | | |
| Included in earnings[(1)] | 142 | 234 |
| Included in regulatory assets and liabilities[(2)] | (264) | (99) |
| Included in accumulated other comprehensive income | 9 | 3 |
| Purchases and settlements, net | (36) | 11 |
| Transfers in or out of Level 3 | (75) | (85) |
| Fair value of derivative contracts, net at end of period | $ 162 | $ 162 |
| Change during the period in unrealized gains (losses) related to net derivative contracts, held at September 30, 2008[(3)] | $ (79) | $ (14) |

(1) $142 million and $234 million reported in Nonutility power generation revenue on Edison International s consolidated statements of income for the three- and nine-month periods ended September 30, 2008, respectively.

(2) $(264) million and $(99) million reported in Purchased power expense and, due to expected recovery through regulatory mechanisms, are offset in Provisions for regulatory adjustment clauses net on Edison International s consolidated statements of income for the three- and nine-month periods ended September 30, 2008, respectively.

(3) $101 million and $56 million reported in Nonutility power generation revenue and $(180) million and $(70) million reported in Purchased power expense on Edison International s consolidated statements of income for the three- and nine-month periods ended September 30, 2008, respectively. Due to expected recovery through regulatory mechanisms, the amounts in Purchased power are offset in Provisions for regulatory adjustment clauses net.

***Nuclear Decommissioning Trusts***

SCE is collecting in rates amounts for the future costs of removal of its nuclear assets, and has placed those amounts in independent trusts. Funds collected, together with accumulated earnings, will be utilized solely for decommissioning. The CPUC has set certain restrictions related to the investments of these trusts.

Trust investments (at fair value) include:

| In millions | Maturity Dates | September 30, 2008 | December 31, 2007 |
|---|---|---|---|
| | | (Unaudited) | |
| Municipal bonds | 2008 2044 | **$ 564** | $ 561 |
| Stocks | | **1,672** | 1,968 |
| United States government issues | 2008 2049 | **318** | 552 |
| Corporate bonds | 2008 2047 | **267** | 241 |
| Short-term | 2008 2009 | **34** | 56 |
| **Total** | | **$ 2,855** | $ 3,378 |

Note: Maturity dates as of September 30, 2008.

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The following table sets forth a summary of changes in the fair value of the trust for the three- and nine-month periods ended September 30, 2008:

| In millions | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2008 |
|---|---|---|
| | (Unaudited) | |
| Balance at beginning of period | $ 3,152 | $ 3,378 |
| Realized losses net | (7) | (13) |
| Unrealized losses net | (240) | (452) |
| Other-than-temporary impairment | (49) | (121) |
| Earnings and other | (1) | 63 |
| **Balance at September 30, 2008** | **$ 2,855** | **$ 2,855** |

The decrease in the trust investments was primarily due to net unrealized losses and other-than-temporary impairment resulting from a volatile stock market environment.

Nuclear decommissioning costs are recovered in utility rates. These costs are expected to be funded from independent decommissioning trusts, which effective January 2007, receive contributions of approximately $46 million per year. Contributions to the decommissioning trusts are reviewed every three years by the CPUC. The next filing is in April 2009 for contribution changes in 2010. These contributions are determined based on an analysis of the current value of trusts assets and long-term forecasts of cost escalation, the estimate and timing of decommissioning costs, and after-tax return on trust investments. Favorable or unfavorable investment performance in a period will not change the amount of contributions for that period. However, trust performance for the three years leading up to a CPUC review proceeding will provide input into future contributions. The CPUC has set certain restrictions related to the investments of these trusts. If additional funds are needed for decommissioning, it is probable that the additional funds will be recoverable through customer rates.

**Note 9. Regulatory Assets and Liabilities**

Regulatory assets included in the consolidated balance sheets are:

| In millions | September 30, 2008 | December 31, 2007 |
|---|---|---|
| | (Unaudited) | |
| **Current:** | | |
| Regulatory balancing accounts | **$ 260** | $ 99 |
| Energy derivatives | **165** | 71 |
| Purchased-power settlements | **2** | 8 |
| Deferred firm transmission rights proceeds | **24** | 15 |
| Other | **3** | 4 |
| | **454** | 197 |
| **Long-term:** | | |
| Regulatory balancing accounts | **14** | 15 |
| Flow-through taxes net | **1,319** | 1,110 |
| Unamortized nuclear investment net | **382** | 405 |
| Nuclear-related asset retirement obligation investment net | **282** | 297 |
| Unamortized coal plant investment net | **81** | 94 |
| Unamortized loss on reacquired debt | **315** | 331 |
| SFAS No. 158 pensions and postretirement benefits | **240** | 231 |
| Energy derivatives | **77** | 70 |
| Environmental remediation | **42** | 64 |
| Other | **128** | 104 |

| | | | | |
|---|---|---|---|---|
| | | **2,880** | | 2,721 |
| **Total Regulatory Assets** | **$** | **3,334** | $ | 2,918 |

Regulatory liabilities included in the consolidated balance sheets are:

| In millions | September 30, 2008 (Unaudited) | December 31, 2007 |
|---|---|---|
| **Current:** | | |
| Regulatory balancing accounts | **$ 1,106** | $ 967 |
| Rate reduction notes transition cost overcollection | **20** | 20 |
| Energy derivatives | **7** | 10 |
| Deferred firm transmission rights costs | **42** | 19 |
| Other | **4** | 3 |
| | **1,179** | 1,019 |
| **Long-term:** | | |
| Regulatory balancing accounts | **10** | |
| Asset retirement obligations | **167** | 793 |
| Costs of removal | **2,319** | 2,230 |
| SFAS No. 158 pensions and other postretirement benefits | **317** | 308 |
| Energy derivatives | **1** | 27 |
| Employee benefit plans | **75** | 75 |
| | **2,889** | 3,433 |
| **Total Regulatory Liabilities** | **$ 4,068** | $ 4,452 |

**Note 10. Preferred and Preference Stock Not Subject to Mandatory Redemption**

In January 2008, SCE repurchased 350,000 shares of 4.08% cumulative preferred stock at a price of $19.50 per share. SCE retired this preferred stock in January 2008 and recorded a $2 million gain on the cancellation of reacquired capital stock (reflected in the caption Additional paid-in capital on the consolidated balance sheets). There is no sinking fund requirement for redemptions or repurchases of preferred stock.

**Note 11. Business Segments**

Edison International s reportable business segments include its electric utility operation segment (SCE), a nonutility power generation segment (EME), and a financial services provider segment (Edison Capital). Included in the nonutility power generation segment are the activities of MEHC, the holding company of EME. MEHC s only substantive activities were its obligations under the senior secured notes which were paid in full on June 25, 2007. MEHC does not have any substantive operations. Edison International evaluates performance of its business segments based on net income.

SCE is a rate-regulated electric utility that supplies electric energy to a 50,000 square-mile area of central, coastal and Southern California. SCE also produces electricity. EME is engaged in the business of developing, acquiring, owning or leasing, operating and selling energy and capacity from electric power generation facilities. EME also conducts hedging and energy trading activities in power markets open to competition. Edison Capital is a provider of financial services with investments worldwide.

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Segment information for the three- and nine-month periods ended September 30, 2008 and 2007 was:

| In millions | Three Months Ended September 30, 2008 | Three Months Ended September 30, 2007 | Nine Months Ended September 30, 2008 | Nine Months Ended September 30, 2007 |
|---|---|---|---|---|
| | | (Unaudited) | | |
| **Operating Revenue:** | | | | |
| Electric utility | **$ 3,284** | $ 3,213 | **$ 8,388** | $ 7,895 |
| Nonutility power generation | **813** | 711 | **2,143** | 1,952 |
| Financial services | **14** | 16 | **44** | 51 |
| All others(1) | | 2 | **1** | 4 |
| Consolidated Edison International | **$ 4,111** | $ 3,942 | **$ 10,576** | $ 9,902 |
| **Net Income (Loss):** | | | | |
| Electric utility(2) | **$ 235** | $ 262 | **$ 542** | $ 587 |
| Nonutility power generation(3) | **209** | 190 | **427** | 256 |
| Financial services | **4** | 15 | **48** | 59 |
| All others(1) | **(9)** | (6) | **(18)** | (15) |
| Consolidated Edison International | **$ 439** | $ 461 | **$ 999** | $ 887 |

(1) Includes amounts from nonutility subsidiaries, as well as Edison International (parent) that are not significant as a reportable segment.

(2) Net income available for common stock.

(3) Includes earnings (loss) from discontinued operations of $6 million and $(4) million for the three months ended September 30, 2008 and 2007, respectively and none and $1 million for the nine months ended September 30, 2008 and 2007, respectively.

**Note 12. Investment in Leveraged Leases, Partnerships and Unconsolidated Subsidiaries**

First Energy exercised an early buyout right under the terms of an existing lease agreement with Edison Capital related to Unit No. 2 of the Beaver Valley Nuclear Power Plant. The termination date of the lease under the early buyout option was June 1, 2008. Proceeds from the sale were $72 million. Edison Capital recorded a pre-tax gain of $41 million ($23 million after tax) during the second quarter of 2008.

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**Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations**

## INTRODUCTION

This MD&A for the three- and nine-month periods ended September 30, 2008 discusses material changes in the consolidated financial condition, results of operations and other developments of Edison International since December 31, 2007, and as compared to the three- and nine-month periods ended September 30, 2007. This discussion presumes that the reader has read or has access to Edison International s MD&A for the calendar year 2007 (the year-ended 2007 MD&A), which was included in Edison International s 2007 annual report to shareholders and incorporated by reference into Edison International s Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission.

This MD&A contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements reflect Edison International s current expectations and projections about future events based on Edison International s knowledge of present facts and circumstances and assumptions about future events and include any statement that does not directly relate to a historical or current fact. Other information distributed by Edison International that is incorporated in this report, or that refers to or incorporates this report, may also contain forward-looking statements. In this report and elsewhere, the words expects, believes, anticipates, estimates, projects, inte plans, probable, may, will, could, would, should, and variations of such words and similar expressions, or discussions of strategy or of intended to identify forward-looking statements. Such statements necessarily involve risks and uncertainties that could cause actual results to differ materially from those anticipated. Some of the risks, uncertainties and other important factors that could cause results to differ, or that otherwise could impact Edison International or its subsidiaries, include, but are not limited to:

- the cost of capital and the ability to borrow funds and access to capital markets on favorable terms, particularly in light of current credit conditions in the capital markets and uncertainty over the global economic outlook;

- the availability and creditworthiness of counterparties to enter into hedge transactions to reduce market price risk;

- the ability to procure sufficient resources to meet expected customer needs in the event of significant counterparty defaults under power-purchase agreements;

- changes in the fair value of investments and other assets;

- the ability of Edison International to meet its financial obligations and to pay dividends on its common stock if its subsidiaries are unable to pay dividends;

- the ability of SCE to recover its costs in a timely manner from its customers through regulated rates;

- decisions and other actions by the CPUC, the FERC and other regulatory authorities and delays in regulatory actions;

- market risks affecting SCE s energy procurement activities;

- changes in interest rates, rates of inflation beyond those rates which may be adjusted from year to year by public utility regulators, and foreign exchange rates;

governmental, statutory, regulatory or administrative changes or initiatives affecting the electricity industry, including the market structure rules applicable to each market;

environmental laws and regulations, both at the state and federal levels, that could require additional expenditures or otherwise affect the cost and manner of doing business;

risks associated with operating nuclear and other power generating facilities, including operating risks, nuclear fuel storage, equipment failure, availability, heat rate, output, and availability and cost of spare parts and repairs;

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the cost and availability of labor, equipment and materials;

the ability to obtain sufficient insurance, including insurance relating to SCE s nuclear facilities;

effects of legal proceedings, changes in or interpretations of tax laws, rates or policies, and changes in accounting standards;

creditworthiness of suppliers and other project participants and their ability to deliver goods and services per their contractual obligations to EME and its subsidiaries;

the outcome of disputes with the IRS and other tax authorities regarding tax positions taken by Edison International;

the continued participation of Edison International s subsidiaries in tax-allocation and payment agreements;

supply and demand for electric capacity and energy, and the resulting prices and dispatch volumes, in the wholesale markets to which EMG s generating units have access;

the cost and availability of coal, natural gas, fuel oil, nuclear fuel, and associated transportation to the extent not recovered through regulated rate cost escalation provisions or balancing accounts;

the cost and availability of emission credits or allowances for emission credits;

transmission congestion in and to each market area and the resulting differences in prices between delivery points;

the ability to provide sufficient collateral in support of hedging activities and purchased power and fuel;

the risk of counterparty default in hedging transactions or power-purchase and fuel contracts;

the extent of additional supplies of capacity, energy and ancillary services from current competitors or new market entrants, including the development of new generation facilities and technologies;

the difficulty of predicting wholesale prices, transmission congestion, energy demand and other aspects of the complex and volatile markets in which EMG and its subsidiaries participate;

general political, economic and business conditions;

weather conditions, natural disasters and other unforeseen events; and the risks inherent in the development of generation projects as well as transmission and distribution infrastructure replacement and expansion including those related to siting, financing, construction, permitting, and governmental approvals.

Additional information about risks and uncertainties, including more detail about the factors described above, are discussed throughout this MD&A and in the Risk Factors section included in Part I, Item 1A of Edison International s Annual Report on Form 10-K. Readers are urged to read this entire report, including the information incorporated by reference, and carefully consider the risks, uncertainties and other factors that affect Edison International s business. Forward-looking statements speak only as of the date they are made and Edison International is not obligated to publicly update or revise forward-looking statements. Readers should review future reports filed by Edison International with the Securities & Exchange Commission.

Edison International is engaged in the business of holding, for investment, the common stock of its subsidiaries. Edison International s principal operating subsidiaries are SCE, a rate-regulated electric utility, and EMG. EMG is the holding company for its principal wholly owned subsidiaries, EME, which is engaged in the business of developing, acquiring, owning or leasing, operating and selling energy and capacity from independent power production facilities, and Edison Capital, a provider of capital and financial services.

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In this MD&A, except when stated to the contrary, references to each of Edison International, SCE, EMG, EME or Edison Capital mean each such company with its subsidiaries on a consolidated basis. References to Edison International (parent) or parent company mean Edison International on a stand-alone basis, not consolidated with its subsidiaries.

This MD&A is presented in 8 major sections. The company-by-company discussion of SCE, EMG, and Edison International (parent) includes discussions of liquidity, market risk exposures, and other matters (as relevant to each principal business segment). The remaining sections discuss Edison International on a consolidated basis. The consolidated sections should be read in conjunction with the discussion of each company s section.

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## CURRENT DEVELOPMENTS

The following section provides a summary of current developments related to Edison International s principal business segments. This section is intended to be a summary of those current developments that management believes are most important. This section is not intended to be an all-inclusive list of all current developments related to each principal business segment and should be read together with all sections of this MD&A.

### EDISON INTERNATIONAL: CURRENT DEVELOPMENTS

#### Financial Markets and Economic Conditions

Global financial markets are experiencing severe credit tightening and a significant increase in volatility, causing access to capital markets to become subject to increased uncertainty and borrowing costs to rise dramatically. In response, U.S. and foreign governments and Central Banks have intervened with programs designed to increase liquidity.

Edison International s subsidiaries are capital intensive businesses and depend on access to the financial markets to fund capital expenditures, meet contractual obligations and support margin and collateral requirements. SCE has significant planned capital expenditures to replace and expand its distribution and transmission infrastructure, and to construct and replace generation assets. EMG has plans to expand its business development activities to grow and diversify its existing portfolio of power projects, including building new power plants, meeting its environmental commitments and making ongoing capital improvements to its existing generation fleet, all of which require liquidity and access to capital markets in the future. See SCE: Liquidity, EMG: Liquidity, and Commitments, Guarantees and Indemnities for further discussion.

Due to the instability of the financial markets, and to provide protection against a dramatic liquidity crisis, in September 2008 Edison International and its subsidiaries borrowed under their various credit facilities a total of $2.1 billion (including $958 million for SCE, $898 million for EMG, and $250 million for Edison International (parent)), although there was no immediate need for such funds. The proceeds from these borrowings were invested in U.S. treasury securities and U.S. treasury and government agency money market funds. As of September 30, 2008, Edison International had $5.4 billion of available liquidity made up of $3.5 billion of cash and short-term investments, as well as $1.9 billion available under the credit facilities. In addition, in October 2008, SCE issued $500 million of 5.75% first and refunding mortgage bonds due in 2014. The bond proceeds further augmented SCE s cash position. Edison International and its subsidiaries do not have any material debt obligations that mature until 2012. See SCE: Liquidity and EMG: Liquidity for further discussion.

While the capital markets are expected to recover over time, it is uncertain how long before a recovery occurs. The level of future growth for SCE will largely be dependent on the outcome of SCE s 2009 GRC (see SCE: Liquidity Capital Expenditures and SCE: Regulatory Matters Current Regulatory Developments 2009 General Rate Case Proceeding ). Also, SCE relies on power-purchase contracts to meet its resource requirements. The financial crisis may adversely affect the ability of counterparties to access the capital markets, as needed, to perform under contracts upon which SCE will rely to meet new generation and RPS requirements. Additionally, if counterparties fail to deliver under power-purchase contracts, SCE would be exposed to potentially volatile spot markets for buying replacement power, but would expect to recover any additional costs through regulatory mechanisms. The volatile market conditions have also affected the value of trusts established at SCE to fund future long-term pension, other postretirement benefits, and nuclear decommissioning obligations. The market decline has eroded the funded status of these plans and unless the market recovers, will result in increased future expense and higher funding levels. SCE currently recovers and expects to continue to recover its pension, other postretirement benefits, and decommissioning costs, through customer rates and therefore funded cost increases are not expected to impact earnings, but may impact the timing of cash flows (see SCE: Liquidity and SCE: Other Developments for further discussion).

EMG has made substantial capital commitments, especially for wind turbines. Pending recovery of the capital markets, EMG intends to preserve capital by focusing on a more selective growth strategy (primarily completion of projects under construction, including the Big Sky project in Illinois, and development of sites for future renewable projects deploying current turbine commitments), and using its cash and future cash flow to meet its existing contractual commitments. Moreover, disruption in the financial markets appears to have reduced trading activity in power markets which may affect the level and duration of future hedging activity and potentially increase the volatility of earnings. See EMG: Liquidity for further discussion. Long-term disruption in the capital markets could adversely affect Edison International s business plans and potentially impact Edison International s financial position.

***Bankruptcy of Lehman Brothers Holdings and Subsidiaries***

On September 15, 2008, Lehman Brothers Holdings filed for protection under Chapter 11 of the U.S. Bankruptcy Code. Three subsidiaries of Lehman Brothers Holdings are lenders in SCE s, EMG s and Edison International (parents) s credit agreements representing, a total commitment of $260 million ($106 million for SCE, $80 million for EMG, and $74 million for Edison International (parent)). In September 2008, two of the three Lehman Brothers Holdings subsidiaries declined requests for funding under SCE s and one of EMG s credit agreements.

Another subsidiary of Lehman Brothers Holdings, Lehman Brothers Commodity Services, Inc., declined to meet a collateral call on power contracts at EMG, including hedge contracts for Midwest Generation for 2009 and 2010. The obligations of this Lehman Brothers Commodity Services, Inc. under the power contracts are guaranteed by Lehman Brothers Holdings. On October 3, 2008 Lehman Brothers Commodity Services, Inc. filed for protection under Chapter 11. The bankruptcy filings and failure to post collateral are events of default under the related agreements. In October 2008, these power contracts were terminated, resulting in claims against Lehman Brothers Holdings and its subsidiary in bankruptcy. As a result of the termination, EME recorded a pre-tax loss of $26 million related to power contracts during the third quarter of 2008 reflected in nonutility power generation revenue on Edison International s consolidated statement of income. See EMG: Market Risk Exposures Accounting for Energy Contracts.

**Federal and State Income Taxes**

Edison International is currently engaged in settlement negotiations with the IRS to reach a Global Settlement which, if consummated, would resolve cross-border, leveraged lease issues in their entirety and all other outstanding tax disputes for open tax years 1986 through 2002, including certain affirmative claims for unrecognized tax benefits. See Edison International Notes to Consolidated Financial Statements Note 3. Income Taxes. These negotiations have progressed to the point where Edison International and the IRS have reached nonbinding, preliminary understandings on the material principles for resolving the lease issues as part of the resolution of all issues included in the Global Settlement. Final resolution of such disputes, as part of the Global Settlement, is subject to reaching definitive agreements on final terms and calculations, mutually satisfactory documentation, and review of all or a portion of the Global Settlement by the Staff of the Joint Committee on Taxation, a committee of the United States Congress (the Joint Committee ). While not assured, Edison International believes that the Global Settlement will be submitted or substantially ready to be submitted to the Joint Committee during the fourth quarter of 2008. See Other Developments Federal and State Income Taxes for further information.

**Enterprise-Wide Software System Project**