

A TRADITION OF SERVICE

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Southern California Edison



CUSTOMER SERVICE

...is more than a policy or goal for the Southern California Edison Company. It means treating customers the way we would like to be treated ourselves.

To remind employees that the Company is committed to serving customer needs, Edison employees in 1985 began wearing buttons with the simple, but fundamental message — Customer Power — along with Edison's long-standing motto — Good Service, Square Dealing, Courteous Treatment.

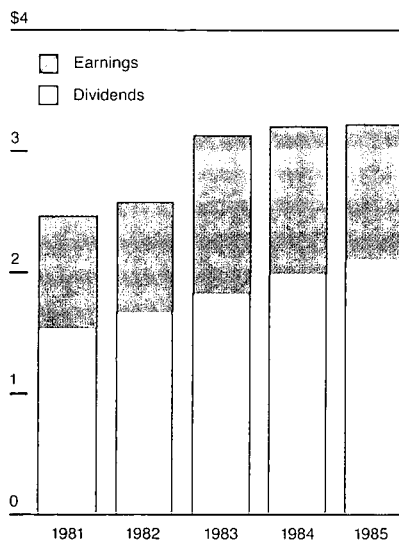
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Southern California Edison Company Annual Report 1985

Highlights	1985	1984	% Change	Five-Year Compound Annual Growth Rate
Operating Revenues (000)	\$5,168,848	\$4,899,152	5.5%	7.1%
Fuel and Purchased Power Costs (000)	\$2,389,087	\$2,084,941	14.6	3.5
Earnings Available for Common and Original Preferred Stock (000)	\$702,409	\$659,385	6.5	22.3
Weighted-Average Shares of Common and Original Preferred Stock (000)	215,649	207,576	3.9	8.0
Earnings Per Share	\$3.26	\$3.18	2.5	13.2
Dividends Paid Per Common Share	\$2.10	\$1.97	6.6	8.6
Total Assets (000)	\$12,593,449	\$11,358,730	10.9	10.3
Funds Used for Construction Expenditures (000)	\$1,076,495	\$852,274	26.3	6.6
Kilowatt-Hour Sales (000)	64,984,566	63,310,047	2.6	1.6
Number of Customers	3,490,325	3,400,182	2.7	2.0
Number of Employees	17,182	16,844	2.0	3.9
Area Generating Capacity at Peak (Megawatts)	17,776	17,354	2.4	2.8

Earnings and Dividends Paid Per Share

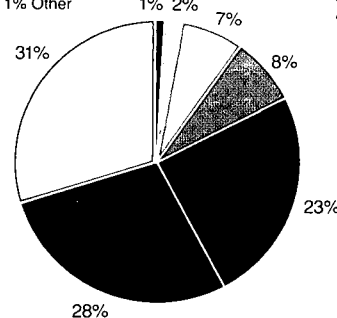


The Company's 1985 earnings per share reached an all-time high of \$3.26, the fifth consecutive year of record earnings. A 5.9 percent increase in the common stock quarterly dividend raised the annual dividend rate to \$2.16 per share.

Sources and Distribution of Revenues

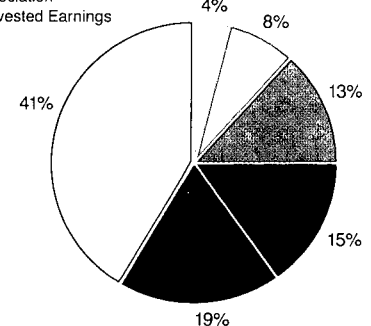
Sources

31% Commercial
28% Residential
23% Industrial
8% Public Authorities
7% Resale
2% Agricultural
1% Other



Distribution

41% Fuel and Purchased Power
19% Operation and Maintenance
15% Dividends and Interest
13% Taxes and Other
8% Depreciation
4% Reinvested Earnings



The Company's sources of revenues in 1985 reflected a balanced contribution from the three major customer classes—commercial, residential and industrial. Fuel and purchased power continue to represent a major portion of the distribution of revenues.

To Our More Than 190,000 Shareholders:

Our corporate goals are to provide a competitive return on investment to our shareholders and reliable electric service at a reasonable price to our customers. Achieving these goals remains challenging, so our successes in 1985 are noteworthy:

- Our earnings of \$3.26 per share were a new record.
- Our common stock price per share reached \$28½ in December, the highest level in Company history, only to be surpassed in February 1986 at \$29¾.
- We raised our common stock dividend from \$2.04 annually to \$2.16 annually. This was the tenth increase in the last nine years.
- Total return to shareholders in dividends and stock appreciation was 26 percent; the average annual total return to shareholders for the past five years slightly exceeded 26 percent.
- Our revenues exceeded \$5 billion for the first time in our history, making us the nation's second largest electric utility.

In addition to these financial accomplishments, 1985 was notable because of achievements in numerous other areas:

- Our coal-fired power plants, despite a tragic accident at the Mohave Generating Station in June, achieved levels of production which, on a four-year average capacity factor basis, will qualify for a bonus award under an incentive formula established by the California Public Utilities Commission (CPUC).
- With the completion of construction at Units 2 and 3 of the San Onofre Nuclear Generating Station, and the return to service of Unit 1 following upgrading work, we operated all three units simultaneously for the first time and have reduced personnel at the Station by 55 percent. The Station's three units together operated at about the industry average capacity factor during the year. That occurred despite the problems generally associated with bringing two new units into full production. It also was achieved despite the need to operate Unit 3 at reduced power to postpone the unit's

scheduled outage for refueling until after the summer peak demand period because of the loss of the Mohave plant's output. Our objective in 1986 is to improve the performance of these nuclear units to exceed the industry average and to reduce their operational expenses.

- Unit 1 at Palo Verde Nuclear Generating Station in Arizona, in which your Company owns a 15.8 percent interest, went through a successful start-up period and began commercial service on February 1, 1986.
- A 300-megawatt cogeneration facility, in which an Edison non-utility subsidiary owns a 50 percent interest, began commercial operation in August as California's largest such facility. It ran at more than a 90 percent capacity factor for the balance of the year.
- Total available renewable and alternative generating resources substantially exceeded our 1980 forecast, providing 10 percent of our energy needs in 1985.

In addition, your Company:

- became the first corporation in the world to issue dollar-denominated "Shogun" bonds in Japan, at significant interest savings to our customers;
- obtained a new two-tier natural gas rate that saved our customers millions of dollars;
- settled, at a cost of \$350 million, a lawsuit with a major oil supplier that will result in net savings to our customers of more than \$1 billion compared with the cost of continuing to purchase fuel oil under the disputed contract;
- reached agreements with two uranium suppliers to terminate long-term contracts, entered in 1976 and 1977, for total settlement payments of \$82 million. This will free the Company to purchase uranium on more favorable terms at an estimated savings of \$190 million over 10 years.

All of these achievements and those described in the text of this report add up to another banner year for your Company in providing a competitive return to shareholders and excellent service to customers.

Our Company motto, penned in 1905—"Good Service, Square Dealing, Courteous Treatment"—still guides us today. In independent attitude surveys conducted for the Company, customers recognize our efforts by giving us increasingly high marks for good service.

Our 17,200 employees work as a team, and our successes in 1985 are due to their dedication, professionalism and hard work. We're proud of these people and thank them for their fine efforts.

The electric utility business has been changing dramatically in the last decade, posing many new challenges. We have developed strategies in all phases of our business to anticipate change and remain flexible. These strategies have strengthened your Company financially, operationally, in employee morale, and in the performance of its public service.

For example, we have been aggressively diversifying our generating resources to strengthen system flexibility and reliability, and to reduce our dependence on fuel oil and natural gas. To implement this strategy, we are:

- Increasing electric production obtained from hydro, coal, nuclear, cogeneration, geothermal, biomass, wind, solar and coal gasification facilities.
- Expanding extra-high-voltage transmission line capacity to the Pacific Northwest and the Southwest so that we can purchase more surplus power, primarily generated by hydroelectric and coal plants. This power is less costly than the power we can generate at our own oil- and gas-fired generating plants and saves our customers millions of dollars each year.
- Entering into long-term firm power contracts for supply of peak-period generating capacity from the Northwest and Southwest sources, at lower cost than building new power plants or extending the lives of existing ones.
- Installing newly developed, high-technology devices to improve the efficiency of our existing steam plants and other electrical facilities.

- Developing ways to store energy generated when demand is low for use at times of peak demand.

- Examining ways to extend the life of older plants at less cost than building new ones.

- Assisting our customers to shift their consumption of electricity to low-use periods when electricity costs less. Our energy management programs will allow us to defer the construction of new generating facilities of about 1,800 megawatts capacity by 1995—more than Edison's share of the output of San Onofre Units 2 and 3 combined.

Last year, 35 percent of the electricity we provided our customers was purchased, primarily from out-of-state hydro- and coal-powered sources. That saved our customers about \$382 million in fuel costs, compared with using natural gas or fuel oil in our own generating plants. Our three nuclear units at San Onofre saved our customers about \$260 million in fuel costs last year.

Your Company obtains electricity from nine different primary energy sources, more than any other utility company in the world. Our diversified resource strategy helps to keep our customers' rates low. At the end of 1985 our customer rates were 3.5 percent lower than in 1982, and when adjusted for inflation, were 15 percent lower than in 1982. Our strategy of reducing dependence upon fuel oil and natural gas, along with the decline in natural gas prices, contributed to this improvement. Close attention to cost control and to improving the productivity of our employees and facilities also helped.

We still face major challenges. One important issue is the CPUC review of the construction costs of San Onofre Units 2 and 3. Those costs are currently reflected in our customer rates, but the CPUC has yet to determine that the costs were reasonably incurred. If the Commission determines that some costs were unreasonable, as requested by its Public Staff Division, there would be a charge against the Company's income, which could be substantial.

We have submitted extensive evidence to the Commission demonstrating that the construction project was well managed and justifying the expenses incurred in construction of those two plants, backed by testimony from nationally recognized experts in the areas of nuclear construction, regulatory policy and environmental affairs.

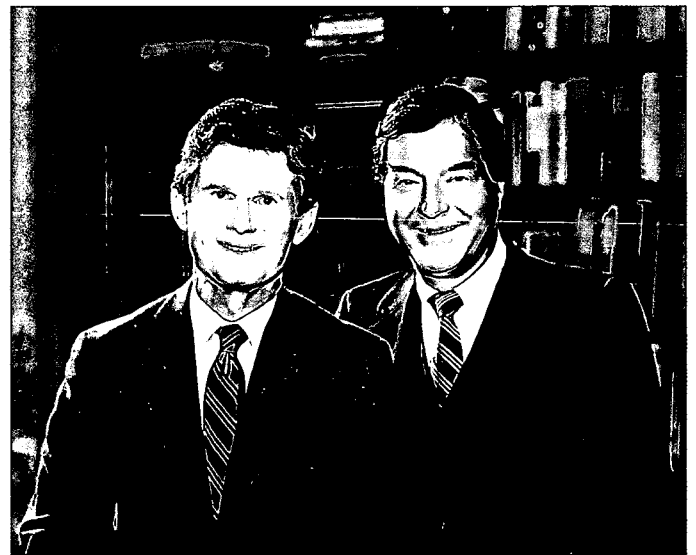
The issues are complex and are more fully described in the "Regulatory and Legislative Review" section of this annual report, beginning on page 25. Suffice to say, we are vigorously opposing the Public Staff's position and, as a result of our testimony, the Staff has been forced to concede significant errors in its analysis and substantially reduce its original recommended disallowance.

Company non-utility subsidiaries have made a limited number of investments in cogeneration, geothermal power and real estate. These are described in the "Year in Review" section of this report. We will continue to evaluate carefully the changing business environment for regulated electric utilities and may make additional investments in non-utility enterprises, where our skills and market opportunities create the potential for attractive returns.

We are fortunate to have gained the services of two new Directors, Dr. James M. Rosser, president of California State University at Los Angeles, and J. J. Pinola, chairman and chief executive officer of First Interstate Bancorp. We lost through retirement in May the counsel of Gerald H. Phipps, who served your Company with distinction as a Director for 21 years. T. M. McDaniel, Jr., who served as president of your Company from 1968 to 1978 and as a Director beginning in 1962, has chosen not to stand for re-election to the Board of Directors in 1986. We will miss his valuable counsel and dedicated service.

In addition, we made one change in senior management. Michael R. Peevey, formerly senior vice president, was elected executive vice president, effective January 1, 1986.

All of us at Edison are proud of the accomplishments of 1985, and it is a privilege and honor to serve as leaders of your Company. On behalf of your Board of Directors, the officers and all of our employees, we thank you for your continued support and pledge our continued efforts to build upon our foundation of success.



H. Frederick Christie *Howard P. Allen*

H. Frederick Christie
President

Howard P. Allen
Chairman of the Board
and Chief Executive Officer

February 20, 1986

Year In Review

During 1985, Southern California Edison Company worked to further diversify its own generating resources and its outside sources of purchased power, strengthened its high priority effort to provide excellent service to its customers, added a near-record number of new customers, worked effectively with regulatory and legislative bodies, and achieved outstanding financial results.

Generating Resources

Today Edison uses nine different basic energy resources to generate electricity—more than any other utility in the world. They are uranium, solar, wind, geothermal, biomass, water, coal, oil and natural gas.

Nuclear Power

San Onofre: With the completion of Units 2 and 3, and the return to service of Unit 1, the Company reached an operating milestone on April 18 when for the first time all three units at the San Onofre Nuclear Generating Station produced power. These three units generated nearly 12 percent of the electricity needed by Edison customers during 1985.

Unit 1 began commercial operation in 1968 and generated electricity at a capacity factor above the national average until early 1982, when it was taken out of service for seismic upgrading, fire protection improvements and other modifications required by the federal Nuclear Regulatory Commission (NRC).

With NRC approval, the 450-mega-watt (MW) Unit 1 returned to service in November 1984. In late November 1985, the Company took the unit out of operation for a scheduled six-month outage for additional modifications required by the NRC and for refueling.

Unit 2 completed its second year of service to Edison customers in August; Unit 3 will mark its second anniversary in April 1986. Each of these units has a capacity of approximately 1,100 MW.

The first refueling of Units 2 and 3 was completed during 1985, and plant modifications also were performed to further increase plant safety and efficiency.

Since the startup of Units 2 and 3, and the restart of Unit 1, these units have displaced the energy equivalent of about 45 million barrels of oil or natural gas, saving customers over \$800 million in fuel costs.

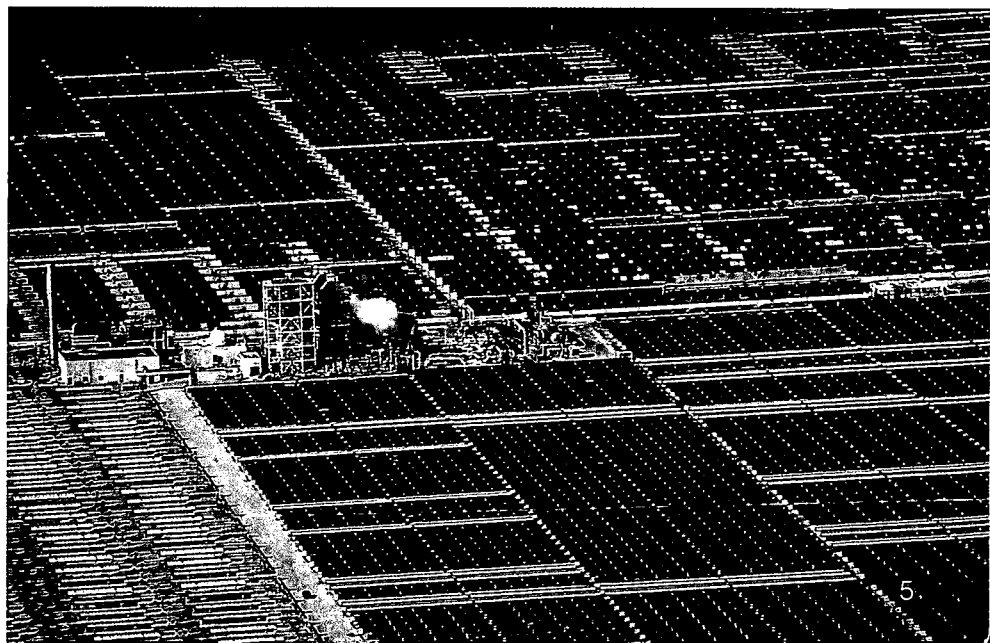
Edison has an 80 percent ownership interest in Unit 1 and a 75 percent interest in Units 2 and 3, for a total share of about 2,000 MW at the San Onofre site. The Company is responsible for managing and operating all three units.

(See "Regulatory and Legislative Review" section on page 25 for a discussion of San Onofre regulatory matters.)

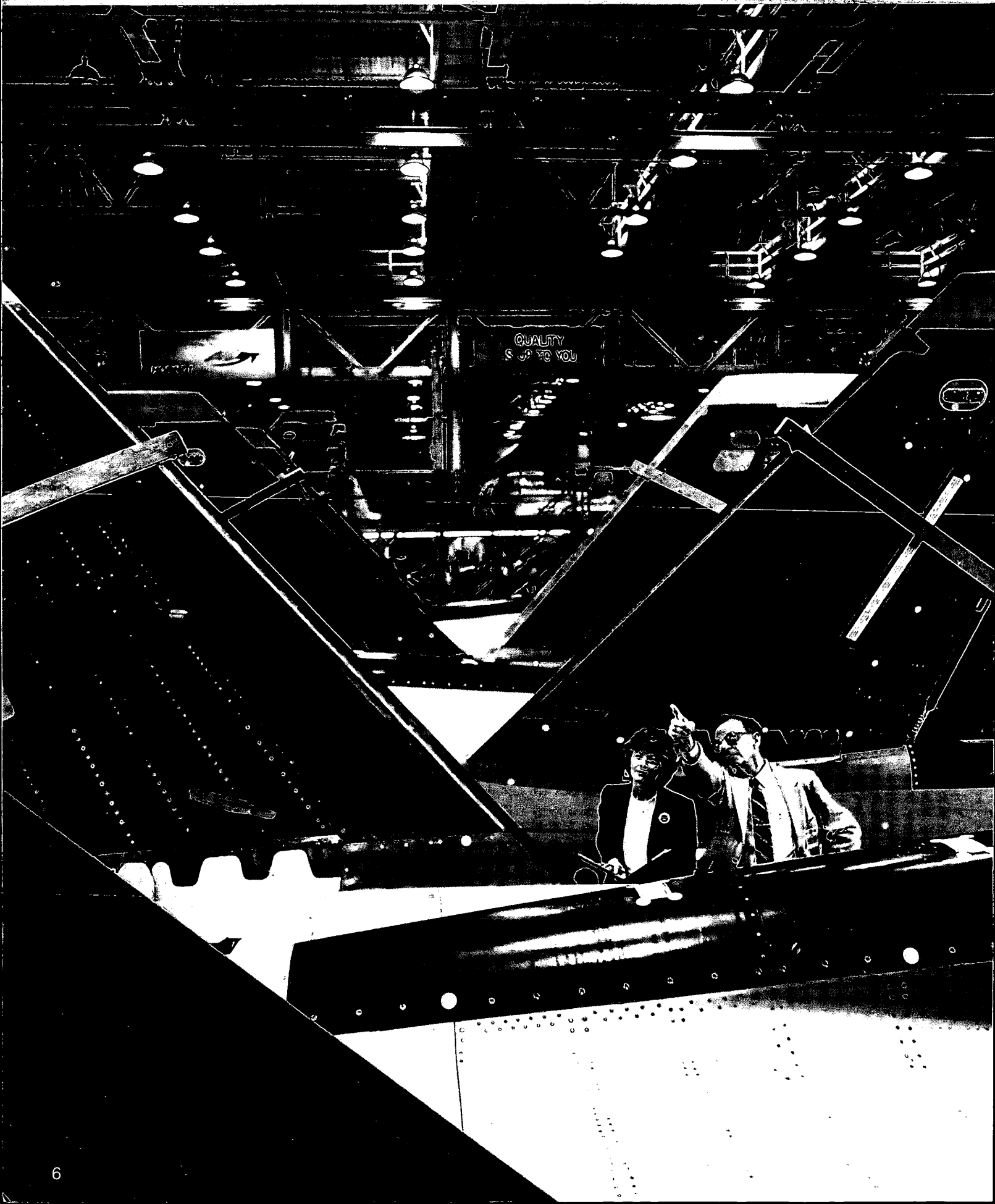
Palo Verde: The Palo Verde Nuclear Generating Station, located near Phoenix, Arizona, will be the largest nuclear facility in the United States when its three 1,222-MW units are completed. Edison has a 15.8 percent ownership interest (579 MW) in the project, which Arizona Public Service Company manages.

During 1985, extensive testing at significant power levels prepared Unit 1 for commercial operation on February 1, 1986. Units 2 and 3 are scheduled to

WORLD'S LARGEST SOLAR PLANT—
A third-party developer designed and built the world's largest solar plant near Barstow, Calif. The first 13.8-MW stage of the plant using solar parabolic troughs began operation in December 1984, followed by the second 30-MW stage in December 1985.



A TRADITION OF SERVICE TO INDUSTRIAL CUSTOMERS



go into operation in late 1986 and late 1987, respectively.

(See "Regulatory and Legislative Review" section on page 25 for a discussion of Palo Verde regulatory matters.)

Renewable and Alternative Energy

Since its decision in 1980 to accelerate the development and use of renewable and alternative resources, Edison has been a leader in developing these resources itself and in working with independent third-party developers who use such technologies.

In 1985 these sources of energy, excluding Edison hydroelectric generation, provided 4 percent of the Company's energy needs. In another decade, they are expected to account for about 22 percent of Edison's projected energy requirements.

The Company's renewable and alternative energy facilities actually on-line and producing electricity at the end of 1985, and projects under contract, but not yet built, are reflected in the table below. However, the Company estimates that only about 60 percent of the third-party projects under contract will be built because of rapidly declining oil prices, expiration of certain energy tax credits and stiffening permitting requirements of the California Energy Commission (CEC).

Southern California Edison Renewable/Alternative Commitments and Resources

	Under Contract But Not Built		On-Line	
	No. of Projects	Megawatts Capacity	No. of Projects	Megawatts Capacity
Third Parties				
Biomass	35	656	15	21
Cogeneration	42	1,903	55	369
Geothermal	28	839	3	60
Small Hydro	37	36	21	52
Solar	7	227	15	45
Wind	64	202	52	83
Third Party Total	213	3,863	161	630
SCE-Owned	14	248	29	187
TOTAL	227	4,111	190	817

Modifications to Northrop Corporation's energy system at its assembly line facility for the F/A-18 Hornet fighter are discussed by Patti Potter, Edison energy services representative, and Earl Locke, manager of plant engineering. Edison has cooperated with Northrop, a major aerospace customer, in various programs to save energy, including the use of more efficient motors and air conditioning units.

While some of the renewable technologies — such as solar, wind, geothermal, biomass and fuel cells — have been made cost-competitive because of tax credits and other special incentives (many of which are no longer available), Edison's extensive experience should position it well to take further advantage of these technologies whenever they are economically attractive options for the Company's customers.

Cogeneration Projects: Cogeneration is an energy technology in which a single source of fuel is used to produce both electricity and thermal energy, generally steam. Unlike many other electricity sources classed as renewable and alternative, cogeneration relies on well-developed technology and in many cases is capable of producing energy at competitive costs without special financial incentives. Both the CPUC and the CEC have encouraged the development of cogeneration projects because of their enhanced fuel efficiency.

Cogeneration has emerged as the mainstay of Edison's renewable and alternative resources program. Some 55 cogeneration projects are currently

HONORED GUEST — California Gov. George Deukmejian joined in ceremonies with Edison's Chairman and Chief Executive Officer Howard P. Allen at the Company's 10-megawatt Solar One generating plant near Daggett during his statewide tour of energy facilities. The governor also visited the adjacent Cool Water Coal Gasification plant and the Kern River Cogeneration facility near Bakersfield.



A TRADITION OF SERVICE TO PUBLIC AUTHORITIES



operational and providing 369 MW of capacity. In addition, Edison has contractual commitments for 42 additional projects with 1,903 MW of capacity.

Solar Projects: Edison now obtains power from four solar technologies—parabolic troughs, central receiver station, parabolic dishes and photovoltaics. These solar projects are all located in the California high desert northeast of Los Angeles.

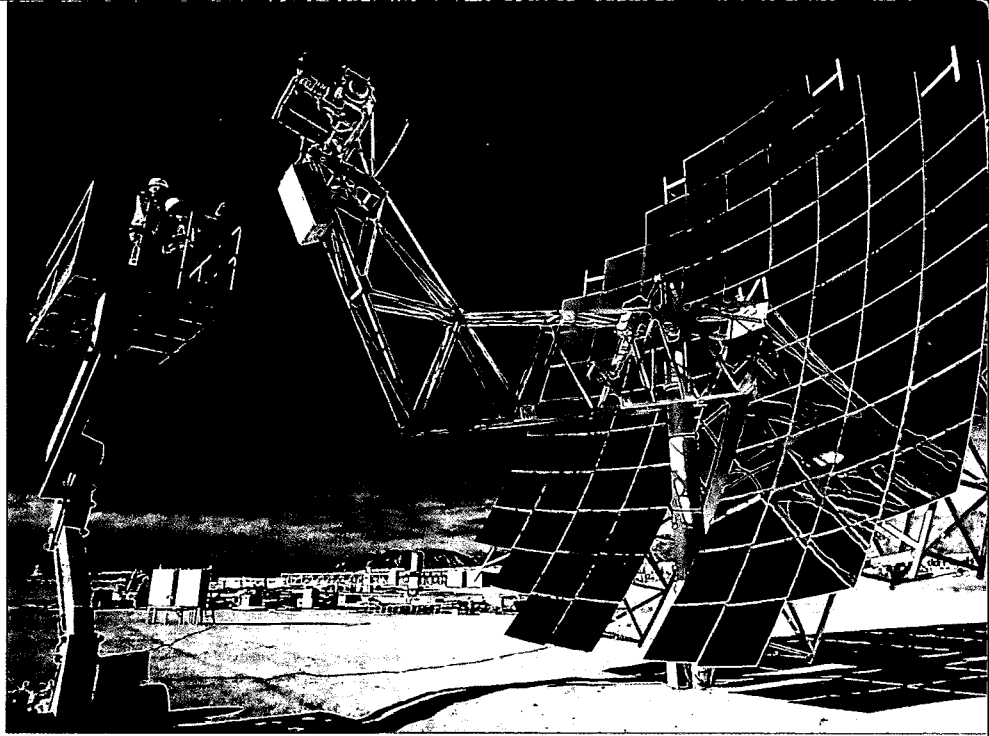
A third-party developer has designed and built the world's largest solar electric generating system (SEGS) which began operation during the year. The plant utilizes parabolic troughs with reflective mirrors to heat oil. It is used to make steam to turn a turbine generator, which provides electricity for Edison customers. The first 13.8-MW stage went into commercial operation in December of 1984, and a second 30-MW stage of the project was completed and began operation in December of 1985.

The 10-MW Solar One project, the world's largest central-receiver solar plant, successfully completed its first year of full-time power production at the end of July. Edison operates the pilot plant, which is jointly funded by the U.S. Department of Energy, Edison and the Los Angeles Department of Water and Power.

In August, Edison began testing an advanced parabolic dish unit that converts sunlight into electricity and operates at about 30 percent efficiency, twice as much as any operating solar energy system.

Although this single 25-kilowatt dish produces much less electricity than other solar systems, a cluster of 2,000 modular units could provide up to 50 MW of power during daylight hours.

Photovoltaic power systems convert sunlight directly into electricity without moving parts. The 1-MW ARCO Solar



facility near Hesperia, Calif., has generated electricity since connection to Edison's grid in November 1982.

Wind: Strong and frequent winds make the San Geronio and Tehachapi passes two of the most suitable locations in Southern California for producing electricity from wind. At year-end, the Company was purchasing 83 MW of effective capacity from private developers at 52 operating wind park projects, including over 7,200 individual wind machines.

The Company's Wind Energy Test Center near Palm Springs continues to serve as a focal point for testing of experimental wind turbine generator designs. This testing allows Edison to obtain data on their performance and reliability for developing more efficient wind turbines.

Geothermal: Edison's 10-MW Salton Sea pilot plant in the Imperial Valley utilizes one of the largest and hottest geothermal resources in the country. Despite the high salt content of the Salton Sea brines, Edison and its partners have advanced the new technology significantly, but falling oil prices have prevented it from being commercially competitive.

The operation of another 10-MW pilot plant in the Imperial Valley, the Brawley Geothermal Electric Project, was discontinued after successful completion of a five-year test program. Its operation

SOLAR PARABOLIC DISH—Edison began testing an advanced solar parabolic dish in September at its Cool Water energy complex near Daggett. The mirrors focus the sun's rays on a highly efficient engine-generator to produce 25 kilowatts of electricity. The dish operates at about 30 percent efficiency for converting sunlight into electricity, about twice as much as any other solar operating system.

Service crew foreman Bob Hartsfield (foreground) and lineman splicer Jim Mearig prepare to inspect an underground electric vault in front of the historic County Court House in Santa Barbara, which first received electricity in 1887. The Company provides reliable electric service to more than 37,000 public authorities.

A TRADITION OF SERVICE TO COMMERCIAL CUSTOMERS



was not continued because the chemistry of the Brawley brines resulted in higher than acceptable operating costs.

Waste-To-Energy: Edison continued to negotiate power purchase agreements with outside developers on various waste-to-energy projects, including the use of municipal and agricultural refuse, the burning of methane gas at landfill sites and using gas from waste treatment facilities.

At the end of 1985, there were 15 projects in operation with a capacity of 21 MW, plus signed contracts for another 35 projects representing 656 MW.

Such projects and cooperative efforts by Edison, city governments and public officials hopefully will contribute to finding environmentally acceptable solutions to the problem of municipal waste disposal in Southern California.

Fuel Cell: During 1985, Edison became the first utility in the nation to use methane gas from a municipal landfill to operate a fuel cell unit and generate electricity. Fuel cells, originally developed to produce electricity for the U.S. space program, convert chemical energy directly into electricity without causing pollution.

Located at a hotel complex in Industry Hills, about 20 miles east of Los Angeles, this experimental 40-kilowatt unit has successfully operated more than 4,300 hours, supplying part of the hotel's electricity and hot water needs.

Small Hydro Projects: Third-party developers are pursuing small hydro applications on various watersheds in Edison's service territory as well as in water conveyance facilities. Edison, too, is developing new small hydro projects.

Workmen install a high-efficiency fluorescent lamp at the South Coast Plaza Mall in Costa Mesa, while Sylvia Smith, SCE energy services specialist, discusses the mall's ongoing energy conservation and load management programs with Richard Shafer, director of engineering. The major shopping center, which has more than 200 retail stores, features many energy-saving techniques that contribute to its overall high operating efficiency.

Edison and small hydro developers currently are operating 42 projects with 119 MW capacity, and Edison has commitments for an additional 50 projects with 84 MW total capacity.

Non-Utility Joint Venture Projects

Under federal law, utilities are allowed to participate up to 50 percent in the development of third-party renewable and alternative resource projects. Edison has entered into such projects through unregulated subsidiaries. These are non-utility projects and are not eligible for recovery of costs and return through traditional utility ratemaking. Instead, they are shareholder investments, which Edison believes will earn a favorable return that will more than justify the risk of such investments.

Cogeneration: California's largest cogeneration facility, the 300-MW Omar Hill project, went into commercial operation in August at Texaco's Kern River oil field near Bakersfield, Calif. In addition to generating electricity, the plant produces steam for injection into the ground to enhance the recovery of heavy crude oil.

Omar Hill, developed by non-utility subsidiaries of Edison and Texaco Inc., marks the Company's first joint

FUEL CELL UNIT—Edison operates the first fuel cell in the nation powered by methane gas from an abandoned landfill. The demonstration unit, which operates quietly and without combustion in Industry Hills, generates electricity directly from the fuel by a chemical reaction.



A TRADITION OF SERVICE TO AGRICULTURAL CUSTOMERS



venture in a major cogeneration project. The \$154 million plant took less than 18 months to build, was completed five months ahead of schedule and was 6 percent under budget.

The Sycamore project, a second 300-MW cogeneration project in the Kern River oil field involving non-utility subsidiaries of Edison and Texaco, is in the process of obtaining permits and is scheduled for operation by June 1987.

Other joint venture agreements for enhanced oil field recovery cogeneration have been reached between Edison non-utility subsidiaries and other parties to develop a 225-MW project in the Midway Sunset field, west of Bakersfield, and an 80-MW project in the Wilmington field, near Long Beach.

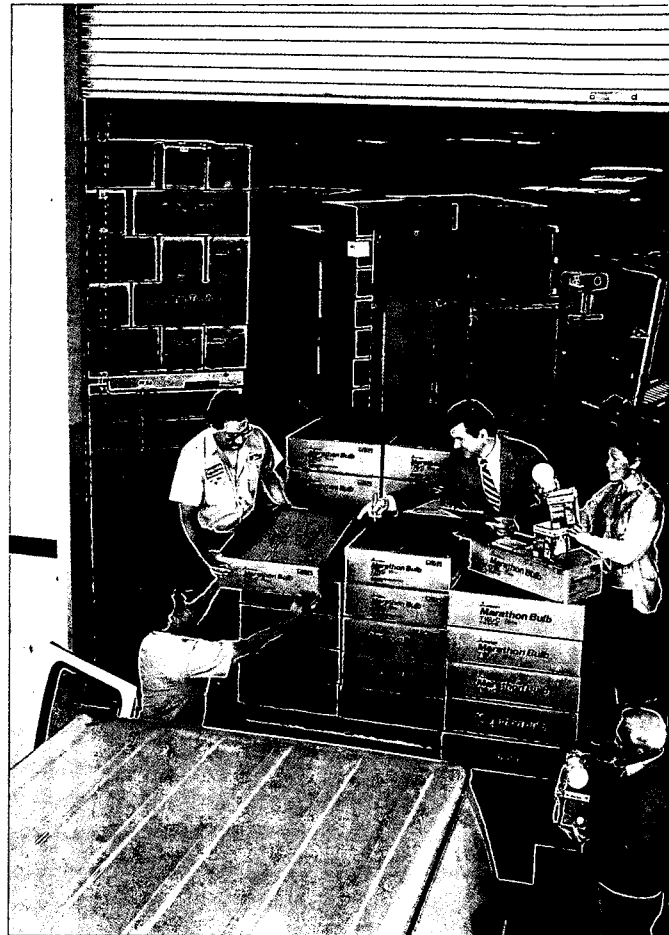
Geothermal: A 15-MW geothermal project near Beowawe, Nevada, began operation in December under a partnership between non-utility subsidiaries of Edison and Chevron, Inc. Unlike the Salton Sea and Brawley plants using highly corrosive geothermal resources, the Beowawe site has much cleaner geothermal fluids and steam. Because its equipment is not subject to the same corrosive brines as the Imperial Valley geothermal sites, the Beowawe plant has lower operating costs and thus is commercially competitive. It is the largest geothermal facility in Nevada, generating enough electricity to meet the needs of 15,000 people.

Large Hydro Resources

The Big Creek hydroelectric system, which was begun in 1910, is the mainstay of the Company's hydro facilities with a capacity of 788 MW. Edison plans to construct additional generating units at five of the eight Big Creek powerhouses that will add 500 MW by the early 1990s.

Two Edison hydraulic test representatives, Mike McCulley (left) and Danny Johnson, test the efficiency of an irrigation pump—a service available for all agricultural customers from Edison since 1924—on a 42,000-acre farm in Central California's San Joaquin Valley. In this highly productive valley, the Company tests about 925 pumps annually. Many of the Company's more than 26,000 agricultural customers benefit from reduced rates for irrigation pumping offered during off-peak periods of electric demand.

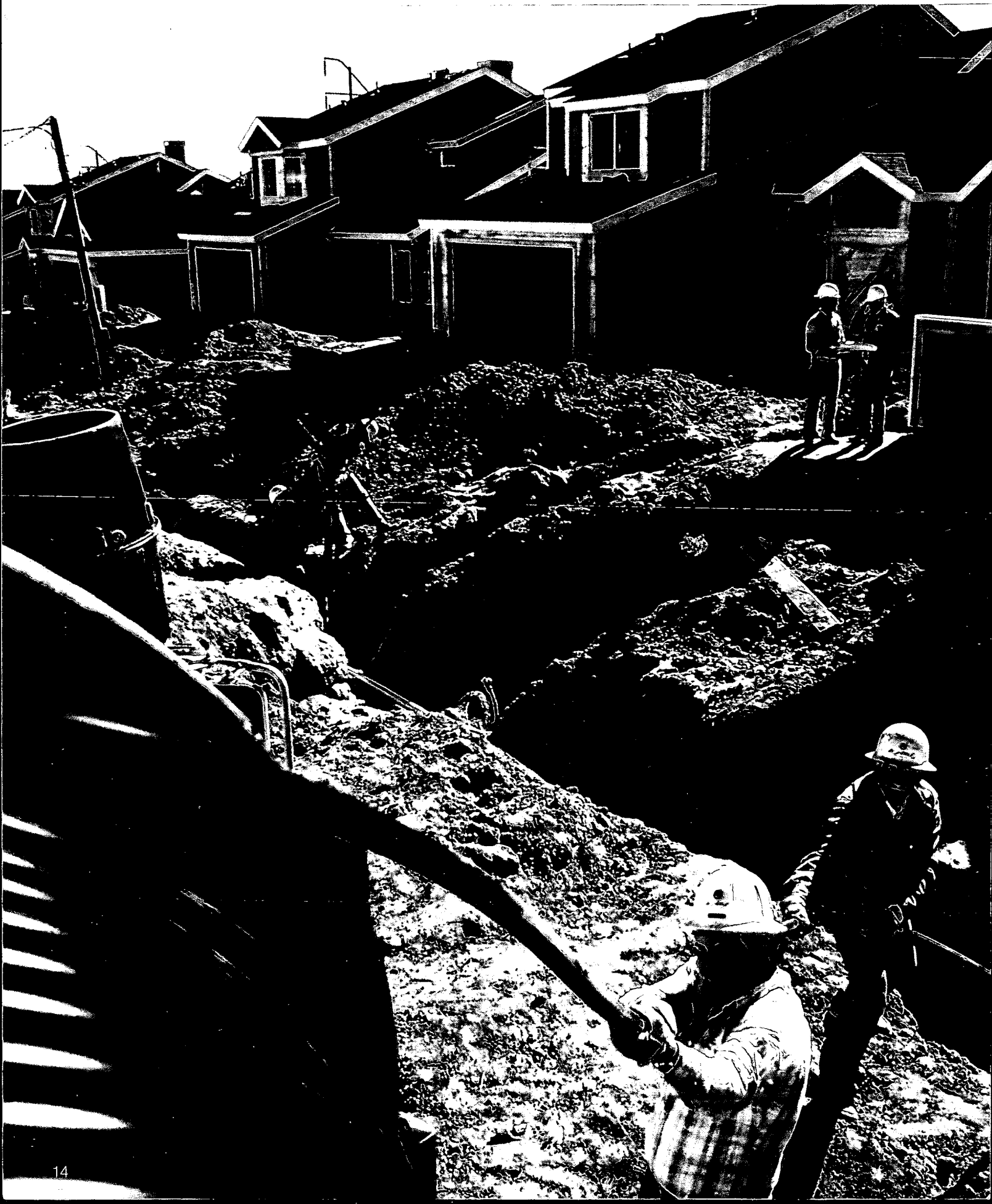
LOW-INCOME ASSISTANCE PROGRAM—Dina Hunter (far right), supervisor of SCE's Energy Assistance Program, examines packages of energy-efficient fluorescent light bulbs at a distribution center. The Company distributed about 100,000 of these bulbs free of charge to qualified low-income families throughout its service territory during 1985 to encourage conservation and reduce their electric bills.



YOUTH MOTIVATION VOLUNTEER PROGRAM—Two Edison volunteers, Earl Lasley (foreground) and Tony Aguilar, speak to a class at Santa Ana High School to urge students to stay in school and complete their education. More than 200 Edison volunteers visited 15,000 students at junior high and high schools throughout the Company's service territory during 1985.



A TRADITION OF SERVICE TO RESIDENTIAL CUSTOMERS



As an expansion of Edison's Big Creek system, the Balsam Meadow project in the Sierra Nevada Mountains progressed on schedule and within budget during 1985. The 200-MW plant was 50 percent complete at year-end. It is being built by blasting and tunneling through solid granite to connect Huntington Lake and Shaver Lake. The power plant will be located 1,000 feet underground. The facility is scheduled to begin operation in January 1988 and will be Edison's largest hydro plant.

Mohave Generating Station

A tragic accident occurred June 9 at the coal-fired Mohave Generating Station in Laughlin, Nevada, when a high-pressure steam line burst at Unit 2, resulting in six fatalities and injuries to 10 other employees.

The entire Edison family was saddened by the loss of life and injuries caused by the accident. Many employees and outside agencies worked heroically to rescue the injured and provide them with emergency medical treatment.

Both generating units at the 1,580-MW plant were removed from service. During the six-month outage, the Company replaced 600 feet of 30-inch steel piping on each of the two units and conducted an extensive safety inspection. The units were returned to service in December.

Edison's share of the \$20 million cost of cleanup and repair, as a 56 percent owner in the plant, was \$11 million. Other owners include the Los Angeles Department of Water and Power, the Salt River Project and the Nevada Power Company.

Research and Development

Edison continues to pursue a wide variety of research and development programs, including new technologies

in generation, transmission, storage, distribution, pollution control and conservation of electrical energy. These activities enhance Edison's operating flexibility by providing more resource options to respond to changing business conditions. Two significant areas in which Edison is engaged are coal gasification and energy storage.

Coal Gasification

The Cool Water Coal Gasification plant completed a successful first year of operation. It is the nation's first commercial-scale project using the most advanced technologies to generate electricity from coal.

The plant converts 1,000 tons of coal per day into a clean-burning gas used in turbines to produce 100 MW. It is in the second year of a five-year test and evaluation program to determine its commercial feasibility.

In addition to taking the power produced by the plant, Edison provided the site for the project and is the plant manager. Other participants in the project include Texaco Inc., Bechtel Power Corporation, General Electric Company, the Electric Power Research Institute and the Japan Cool Water Partnership.

COMMUNITY ASSISTANCE PROGRAM—Joe Labarrere (far right), senior consumer advisor, speaks to senior citizens in Rosemead as part of the Company's efforts to help meet the special needs of elderly customers. Customer service personnel make presentations to various groups, advising them of the services offered by Edison to help them save money and energy.



An Edison crew, including John Trappe (foreground) and Al Kaustinen, pulls an underground cable to provide electric service for a new housing development in Moreno Valley, located in an area east of Los Angeles known as the "Inland Empire," which includes Riverside and San Bernardino counties. The Inland Empire is one of the fastest-growing residential areas in California and represented about 40 percent of the growth in new residential customers for Edison's service territory during 1985.

Energy Storage

Among the more promising new technologies in Edison's research and development program is compressed air energy storage. This technology would allow the Company to pump air with huge compressors using less expensive power during off-peak periods and store it in large underground reservoirs. This compressed air, in turn, would later be released to drive a turbine generator during peak periods of electric demand when costs for generating power are much higher. The cost difference in electricity between peak and non-peak periods makes energy storage technology an attractive option.

The Company began exploratory drilling for an underground reservoir late in the year. If a suitable site is found, it plans to develop a 50-MW unit that would be operational in the mid-1990s.

Purchased Power

The purchase of less expensive electricity from the Pacific Northwest and Southwest continues to save money for Edison customers. These purchases, typically surplus energy from power plants using hydro and coal resources, are less costly than electricity generated from oil- and gas-fired plants.

The Company obtained 35 percent of its electricity during 1985 through the purchase of power from outside sources. By comparison, Edison purchased only 16 percent of its electricity from these outside sources in 1975. The 1985 purchases saved Edison customers about \$382 million compared to using natural gas fuel in its generating plants. Nevertheless, the average cost of purchased power rose sharply to 2.8 cents per kilowatt-hour (KWH) in 1985 from 2.2 cents in 1984, partly because the Bonneville Power Administration's restrictive transmission access policy resulted in higher costs from the Pacific Northwest.

Northwest Transmission

The Pacific Intertie transmission system built in the 1960s is the major artery for transmitting power between the Pacific Northwest and California. It includes two alternating current (AC)

transmission lines and one direct current (DC) line, all capable of transmitting large amounts of electricity in either direction at extra-high voltages. The operation of the Pacific Intertie system benefits both regions, allowing the Northwest to market its surplus power, which saves Edison customers hundreds of millions of dollars, and also making California power sources available to the Northwest.

During 1985, the DC line of the Pacific Intertie was upgraded, increasing Edison's share of the line's transmission capacity to 430 MW. Additional expansion, expected to be completed in 1990, will increase Edison's transmission capability by another 236 MW.

The California-Oregon Transmission Project for a third 500-KV AC line to the Pacific Northwest is being developed jointly by California utilities, including Edison, and the federal Western Area Power Administration. When completed in the early 1990s, it will add about 300 MW to Edison's transmission capability.

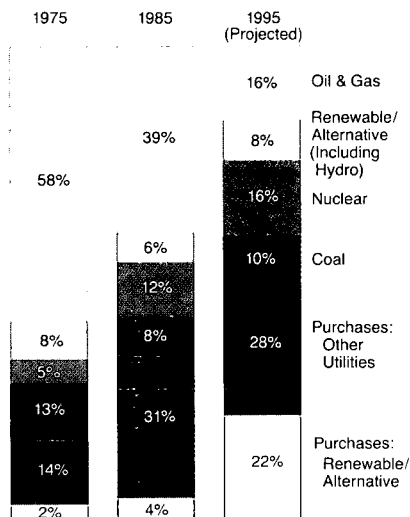
The completion of these upgrades in transmission capacity, plus other smaller upgrades in the existing AC lines, will increase the total transfer capacity between California and the Pacific Northwest to about 7,900 MW, with the Company's share climbing to approximately 1,770 MW.

Bonneville Power Transmission

Policy: The federal Bonneville Power Administration (BPA) introduced an interim policy in late 1984 which acts to arbitrarily limit access to the Pacific Intertie in the Northwest. This has substantially reduced price competition among Pacific Northwest utilities as sellers of electricity to California and virtually eliminated sales by Canadian utilities who no longer can gain access. The result has been an unfair increase in electric rates to Southern California customers of an estimated \$100 million annually.

Electricity rates in the Pacific Northwest are among the lowest in the nation, thanks to inexpensive hydroelectric power from facilities built by federal taxpayer subsidy. As federal taxpayers, Edison customers should not be forced by BPA to subsidize low

Generation Fuel Mix



Edison's long-term resource goals call for a balanced generation fuel mix with a substantial reduction in dependence on oil as a generation resource. Since 1975, the Company has reduced its usage of oil and gas by nearly one-third

electricity rates in the Pacific Northwest by BPA's exporting of unfair and inequitable costs to California. To correct this unfair situation, the Company, together with other utilities and California regulators, are negotiating with BPA to obtain an Intertie access policy that provides fair and equitable costs to all customers, not just to Pacific Northwest customers.

Fuel Supply and Costs

Fuel and purchased power continue to represent the single largest cost of providing electrical service to Edison customers, amounting to \$2.4 billion in 1985, or about 41 cents of each revenue dollar. This compares to the Company's record \$2.6 billion paid for fuel and purchased power in 1981, which represented 62 cents out of each revenue dollar.

The Company used natural gas and oil at its power plants in 1985 to produce 39 percent of the electricity needed by customers, up from 30 percent in 1984 when more inexpensive hydroelectric power was available. This is the energy equivalent of approximately 50 million barrels of fuel oil. Because of the availability of natural gas, Edison only used 2.3 million barrels of oil in 1985.

Ten years ago, natural gas was not expected to be available for electric generation in 1985, and Edison projected the need to burn more than 70 million barrels of fuel oil. This is another example of how the electric business has changed.

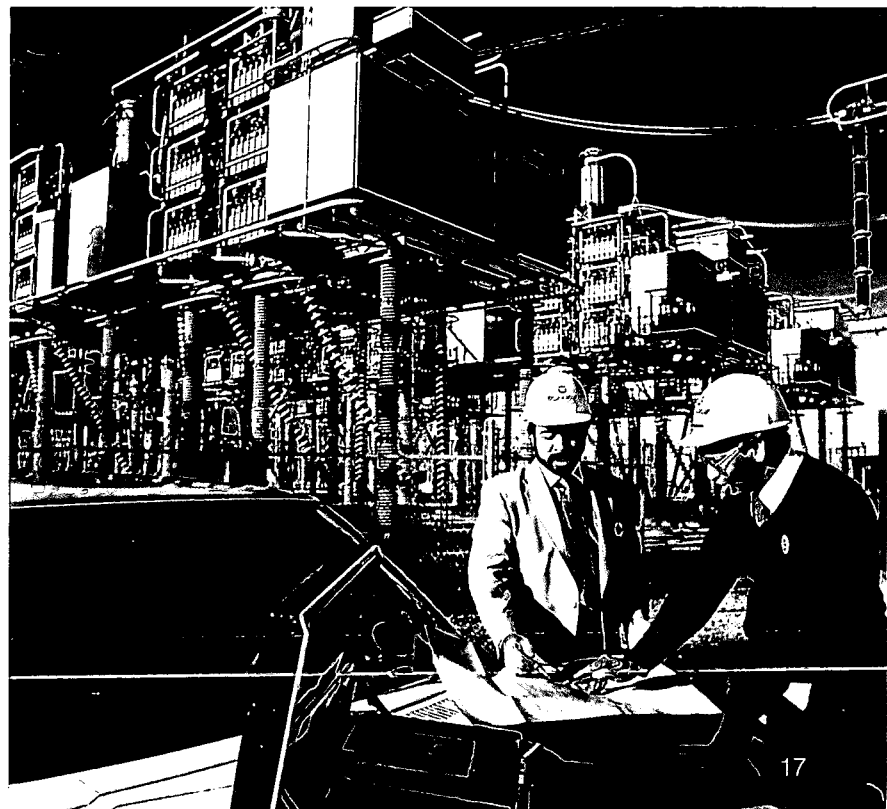
Oil and Uranium Contracts

In the 1970s, when there was serious concern about the rising price and reliability of fuel supply, the Company and regulatory authorities recognized the need for long-term fuel contracts to protect the interests of customers. These contracts were prudent and seemed mandatory at the time, although today, in hindsight, they are no longer necessary. Oil and uranium prices have decreased dramatically in the world market, and adequate supplies are more readily available. Edison, at considerable one-time costs, terminated the contracts in a manner that ultimately will save customers over \$1.2 billion.

TRANSMISSION CONSTRUCTION—A helicopter lowers a segment of a new transmission tower into place as part of Edison's 82-mile extension of a 500-KV line from its Devers Substation near Palm Springs to the Serrano Substation in Orange County. The major project will be completed in 1986.



NEW TRANSMISSION EQUIPMENT—Two Edison engineers discuss a "damping" device (background) that will allow Edison to increase the efficiency and power transfer capability of a transmission line. The device prevents electrical impulses produced by some transmission lines from feeding back into power plants and damaging generating equipment.



The Company has filed with appropriate regulatory agencies to recover the costs of these contract terminations.

Chevron Settlement: Edison paid Chevron Corporation \$350 million in May to settle litigation begun in 1982 when the Company terminated an oil-supply contract before completion of its 10-year term.

Under terms of the contract signed in 1976, Chevron agreed to supply Edison with up to 40 million barrels of low-sulfur fuel oil each year. Although the arrangement provided a secure source of competitively priced oil for many years, the world oil supply increased dramatically in the 1980s, and oil prices fell. At the same time, the natural gas shortages of the 1970s ended, and Edison was able to increase purchases of less expensive power from the Pacific Northwest and Southwest. The combination of the events caused Edison to terminate the Chevron contract. If the contract had not been terminated, Edison customers would have paid \$1.4 billion more for electricity because other sources of energy were far less expensive than the oil under contract. With the settlement, however, the Company saved its customers over \$1 billion.

The settlement also included a new 10-year contract under which Chevron agreed to supply oil at the market price on short notice. Edison will pay Chevron \$9 million annually for the standby service, an amount partially offset by lower oil inventory costs.

In December, unseasonably cold weather resulted in gas suppliers cutting off deliveries of natural gas to Edison and forcing the Company to burn 1.5 million barrels of oil. This reduced Edison's oil inventory to 6.1 million barrels, the lowest level since 1969. At that time, Chevron delivered oil under this standby option contract, which was the first purchase of oil by the Company in more than three and one-half years.

On May 13, 1985, Edison filed an application with the CPUC to recover the \$350 million Chevron settlement payment over a two-year period.

Uranium Contracts: To take advantage of significant decreases in the market price of uranium fuel, Edison negotiated early termination of uranium fuel contracts for \$82 million with two suppliers during the year. As a result, the Company now can purchase lower cost uranium from other sources, which will reduce its future nuclear fuel expenses by an estimated \$190 million.

In early 1986, the Company applied to the CPUC and the Federal Energy Regulatory Commission to recover the \$82 million in payments made to Homestake Mining Company and Bear Creek Uranium Company.

Energy Sales

Total energy sales for the year were 65.0 billion KWH, a 2.6 percent increase over sales in 1984. Over the last five years the growth rate in KWH sales has been 1.6 percent per year, and the Company projects a 1.7 percent annual growth rate over the next 10 years.

The net gain in meters (customers) during 1985 was 92,587, the second highest growth in the past 21 years, and a 23 percent increase over 1984.

The Company's residential customers accounted for 28 percent of total sales. There was a 1.6 percent increase in residential consumption over 1984, largely the result of the addition of 78,263 new residential customers during 1985.

Industrial sales declined 1.0 percent from 1984, in part because some companies bypassed Edison through development of onsite cogeneration projects to meet all, or part, of their electricity requirements.

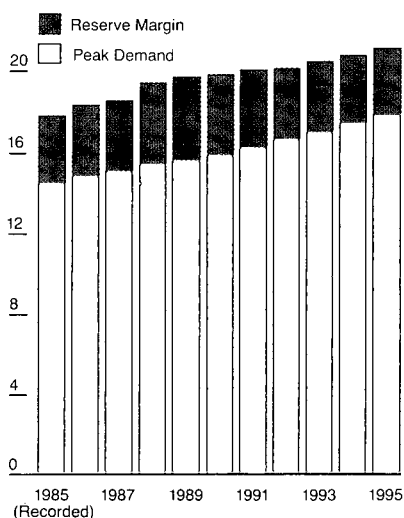
Commercial sales grew 4.1 percent, while sales to agricultural customers decreased 1.3 percent from the previous year.

Peak Demand

The peak customer demand for electricity during the year was 14,587 MW, which occurred on August 30. This is below the record peak of 15,189 MW,

Projected Peak Demand and Reserve Margin

24 Megawatts (Thousands)



Edison's long-range target reserve margin of 16 to 20 percent will be temporarily exceeded because of near-term capacity additions. However, the Company expects to reach its target reserve margin by the early 1990s.

set during a heat wave on September 5, 1984. Over the next 10 years, Edison projects a 2 percent annual growth rate in peak demand, reaching 17,870 MW in 1995.

Non-Utility Real Estate Subsidiary

Edison's non-utility real estate subsidiary is engaged primarily in the development and management of industrial parks. At year-end, it had developed and was managing about 2 million square-feet of space in three industrial parks. It also owns a 79 percent interest in Calabasas Park Company, which holds land for residential development, and a 51 percent interest in Ontario Airport Industrial Park Company.

During 1985, the subsidiary sold a number of its holdings at Calabasas Park. Its intent is to sell all interest in residential development and to concentrate on industrial park development. In addition to its developed industrial properties, it holds over 200 acres of land zoned for industrial development which it plans to develop in the coming years.

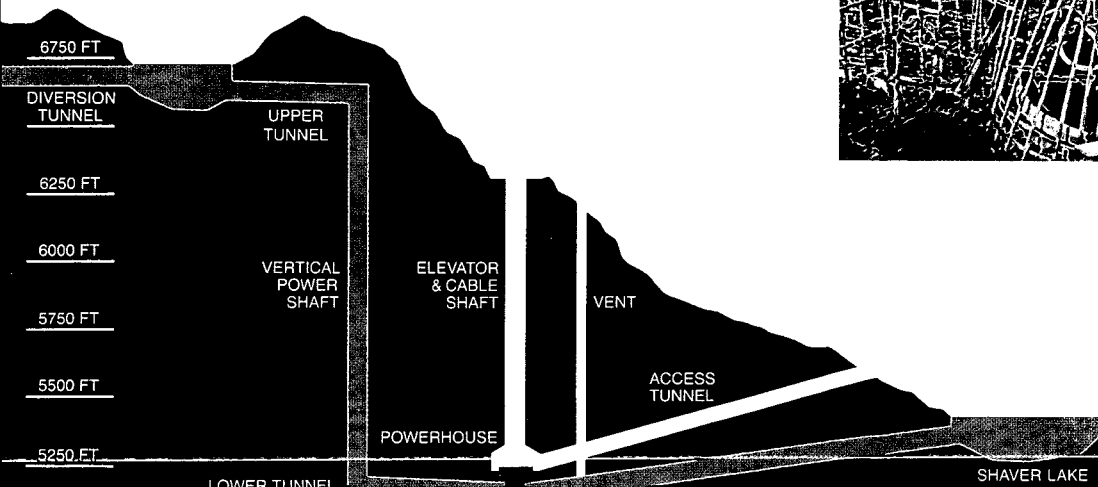
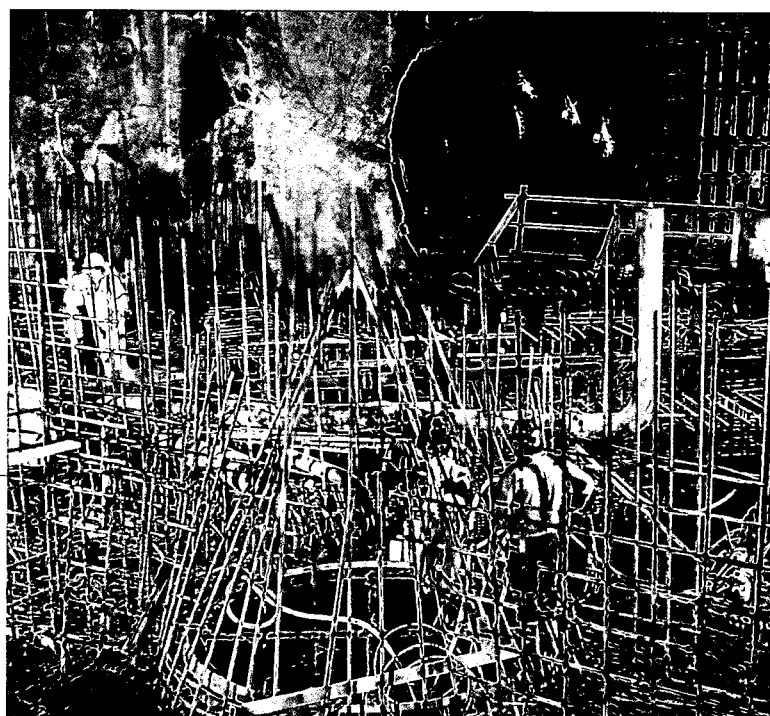
Customer Service

Edison's goals are to provide reliable electric service at reasonable cost, and to treat all customers in an efficient, professional and courteous manner.

The Company has a variety of ongoing programs that reinforce with all employees the long-standing motto of "Good Service, Square Dealing, Courteous Treatment," and which emphasize "treating the customer as you yourself would want to be treated."

Various surveys conducted by outside firms are utilized on a continuing basis to monitor customer opinion and perception of Edison's service. The Company's 1985 survey data indicate that 80 percent of Edison's customers have a favorable opinion of Edison's service. Even so, there are still opportunities for improvement. The Company is committed to continually seek new ways to better serve its customers in today's changing and challenging consumer environment.

As demographics change within Edison's service territory, there likewise



BALSAM MEADOW HYDRO—Workmen place concrete for a hydroelectric powerhouse, located 1,000 feet underground, that will connect with a water tunnel blasted through solid granite. Excavation and construction progressed on schedule during 1985 at the 200-megawatt project, which is part of Edison's Big Creek hydroelectric complex in the Sierra Nevada.

**Rate Comparison with
25 Largest U.S. Cities**
500 KWH/Month

	Monthly Bill
*1. Seattle	\$ 8.76
*2. Memphis	27.66
3. New Orleans	30.68
4. Indianapolis	31.94
5. Milwaukee	32.60
6. Washington, D.C.	35.00
7. Columbus	37.25
*8. Los Angeles	37.51
9. San Antonio	37.72
10. Chicago	38.32
11. Denver	38.90
12. Jacksonville	39.65
Edison	40.09
13. Dallas	40.48
14. Detroit	41.06
Average/25 Cities	41.50
15. Houston	41.53
16. Baltimore	41.57
17. San Francisco	42.46
18. El Paso	43.13
19. Phoenix	45.71
20. Cleveland	46.00
21. Honolulu	52.51
22. Boston	55.00
23. Philadelphia	58.35
24. San Diego	65.00
25. New York	68.87

*Municipally owned utilities

The average Edison residential customer uses approximately 500 KWH of electricity per month and pays 3 percent less than the average for residential customers at the same usage level in the 25 largest cities in the United States. At year-end 1985, Edison's customer rates were 3.5 percent lower than in 1982, when the Company's rates peaked.

are changing service needs of Hispanics, Asians, the elderly, and in households where both parents work full-time. The Company continues to develop programs to meet these needs, such as the Senior Consumer Energy Program introduced in 1985 to provide advice to elderly customers of services offered by Edison and outside agencies to help them save money and energy. Other examples are the informational materials and translation services provided in Spanish, Vietnamese and several other foreign languages.

Energy Management

The Company's Energy Management programs are designed to help customers conserve energy and hold down their electricity bills, while also increasing Edison's operating efficiency by shifting the use of electricity from periods of high use to times of lower demand, thereby deferring the need for new generating plants.

At the end of 1985, the Company's total energy management programs represented savings of nearly 1,000 MW in electric capacity, roughly equivalent to a large nuclear generating unit. By 1995, Edison's continuing energy management efforts will reduce the amount of needed capacity additions by another 880 MW.

In addition to providing information to customers on ways to save energy, the Company offers financial incentives to partially offset customer purchases of energy-efficient equipment and appliances. Edison also continued CPUC-approved programs to increase the conservation efforts of low-income and senior citizen customers, completed more than 40,000 free home energy surveys and distributed energy-efficient equipment.

**PERCENTAGE OF
MALE, FEMALE
AND MINORITY
EMPLOYEES AT
YEAR-END
1980 and 1985**

	Male %		Female %		Black %		Asian American %		American Indian %		Hispanic %		Total Minorities %	
	Year-End 1980	Year-End 1985	Year-End 1980	Year-End 1985	Year-End 1980	Year-End 1985	Year-End 1980	Year-End 1985	Year-End 1980	Year-End 1985	Year-End 1980	Year-End 1985	Year-End 1980	Year-End 1985
Management ⁽¹⁾	88.0	81.3	12.0	18.7	3.0	3.8	5.1	6.5	0.5	0.5	6.2	8.5	14.9	19.2
Non-Management ⁽²⁾	76.1	72.7	23.9	27.3	9.0	9.5	2.8	3.8	0.9	1.2	16.6	20.2	29.3	34.6
Total Company ⁽³⁾	79.8	75.8	20.2	24.2	7.1	7.5	3.6	4.7	0.8	0.9	13.4	16.0	24.8	29.1

(1) Management employees include the "Officials and Managers" and "Professionals" Affirmative Action Categories.

(2) Non-Management employees include the "Technicians," "Office and Clerical," "Craftsmen," "Operators," "Laborers," and

Edison People

The significant financial, operating and public service successes of 1985 could not have been accomplished without the hard work of the 17,200 employees who make up the Edison family. These people are dedicated to providing reliable service at a reasonable cost to 9.5 million people living in Edison's 50,000 square-mile service territory.

Nowhere is this commitment more evident than during fire, heat and windstorms when service crews and support personnel work around-the-clock to maintain and restore service.

As the electric utility business becomes more complex, the Company continues to expand and upgrade its training of employees to improve their professional, technical, communications and interpersonal skills to increase their productivity and to help them respond to customer needs more efficiently.

Affirmative Action

The Company increased the proportion of both minorities and females in its workforce during 1985. The minority representation rose to 29.1 percent from 28.1 percent in 1984, and female employees increased to 24.2 percent from 23.6 percent in the previous year. During the five-year period from 1980 to the end of 1985, minorities in management positions increased to 19.2 percent from 14.9 percent, and female management positions climbed to 18.7 percent from 12.0 percent.

Edison established a Female and Minority Business Development program within its procurement division in 1979. Since then, the number of female

and minority enterprises qualified to do business with Edison has risen by more than 268 percent, from 207 to 762. The value of contracts awarded to these firms increased from \$3.7 million in 1979 to \$57.7 million during 1985.

Community Involvement

Edison has a long and proud tradition of community involvement both by the Company and by many members of the Edison family. Edison encourages its employees to participate in community affairs and in programs such as Scouting, the Special Olympics, YMCA, YWCA and United Way.

The Company also provides financial support to a wide variety of worthy programs in communities throughout its service territory. These include cultural and educational activities, as well as programs to assist youngsters, senior citizens, the needy and underprivileged. Edison also actively assists some community programs, including:

- Student and Employee Development Program—Edison employee volunteers visit junior high and high schools, urging students to stay in school and complete their education. More than 200 Edison volunteers spoke to over 15,000 students during the year.
- Junior Achievement—This program helps give high school students experience in learning about the free enterprise system by running a business.

During 1985, there were over 160 volunteer Edison employees and more than 1,000 students.

- Adopt-A-School—In this business/educational partnership program, companies collaborate with high schools and share their expertise and resources. During 1985, Edison representatives worked with 18 schools, speaking in classrooms, sharing films and instructional materials, assisting in career counseling, serving on advisory councils and providing support in other educational programs.

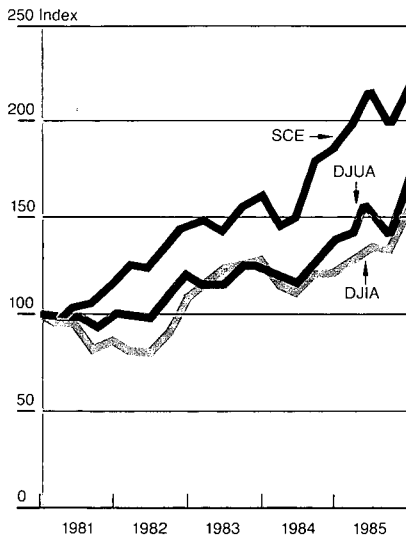
During the Company's 20th annual United Way campaign to help the needy and underprivileged, Edison employees in 1985 voluntarily contributed a record \$2.6 million, a 12.9 percent increase over 1984. Nearly 86 percent of Edison employees participated, with an average per capita contribution of \$155, representing one of the most generous groups of United Way donors in Southern California.

FIREFIGHTING ASSISTANCE—

An Edison lineman waters down a power pole to help maintain electric service during one of the major fires in Southern California. The Company's dedicated service crews and support personnel work around the clock under difficult conditions to maintain or restore service to customers during severe wind, rain, fire and heat storms.



Stock Price Comparison



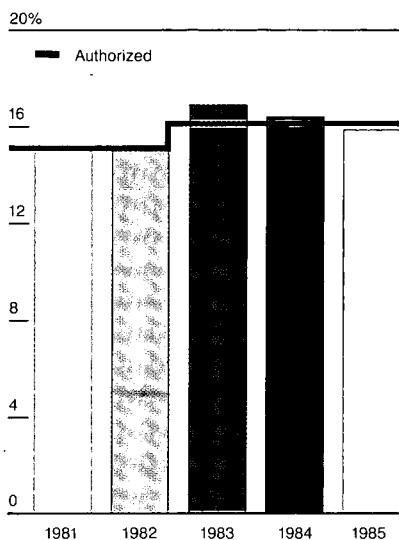
Over the past five years, the Company's stock price has outperformed both the Dow Jones Utility Average and the Dow Jones Industrial Average.

Financial Review

The Company continued to strengthen its financial condition during the year:

- Earnings per share of common stock increased to an all-time high of \$3.26, the fifth consecutive year of record earnings.
- The quality of earnings reached its highest level in 10 years — the percentage of earnings exclusive of non-cash Allowance for Funds Used During Construction increased to 78 percent.
- The common stock dividend was increased by 5.9 percent to \$2.16 a year.
- The market price of common stock reached an all-time high of \$28½ in December 1985. This level was then surpassed in February 1986 at \$29¾.
- Total return to common stock shareholders in dividends and stock appreciation was 26 percent and has averaged slightly over 26 percent compounded annually over the past five years.
- Pretax interest coverage reached 4.4 times, the highest level achieved in 20 years.
- Internal generation of funds reached 68 percent of capital requirements, the highest level in over 25 years.

Rate of Return on Common Equity



The Company has been able to earn at or near its authorized return level over the past five years because of strict internal cost controls, emphasis on employee productivity and timely rate relief. The Company earned a 15.75 percent rate of return on common equity in 1985, compared with a CPUC authorized rate of 16 percent.

Dividend Increase

One of the Company's principal objectives is to provide a competitive return to common stockholders. In keeping with this objective, the Board of Directors in June 1985 approved the tenth dividend increase by the Company in the last nine years. Over that time, dividend increases have exceeded the rate of inflation as measured by the Consumer Price Index. The new dividend rate of \$2.16 a share annually is 5.9 percent higher than the old rate of \$2.04 annually.

The current dividend provided an 8.1 percent yield on Edison's year-end 1985 common stock market price of \$26⅝ per share.

Dividend Reinvestment and Stock Purchase Plan Modified

In October 1985, the Board of Directors approved a modification to the Dividend Reinvestment and Stock Purchase Plan. Beginning with the January 1986 dividend payment, shares were purchased by the Company in the open market. Prior to that time the Company had issued new shares for dividend reinvestment stock purchases.

The Plan was changed for two reasons. First, the tax law provisions, which allowed individuals to defer from taxable income up to \$750 (\$1,500 for a couple filing a joint return) of reinvested dividends, expired on December 31, 1985. These provisions required that dividends be reinvested in newly issued stock rather than in open market purchases. Second, the Company's cash flow has improved, which, in turn, has reduced the need for new equity capital.

More than 44,000 shareholders, or about 27 percent of the holders of Edison common stock, were participating in the Dividend Reinvestment and Stock Purchase Plan at year-end. These participants held approximately 23 million shares representing over 10 percent of the total number of shares

Record Earnings and Revenues

The Company's record per share earnings of \$3.26 were 2.5 percent higher than the \$3.18 per share earned in 1984. The increase resulted from tight cost controls, lower maintenance expense, timely rate relief and reduced interest costs. Edison's earnings per share have grown at a compound annual rate of 13 percent over the past five years.

The rate of return on common equity was 15.75 percent, slightly below the 16 percent level authorized by the CPUC.

Net income for 1985 totaled \$774 million on operating revenues of \$5.17 billion. Both were records for the Company. They compare with net income of \$732 million on operating revenues of \$4.90 billion in 1984.

outstanding. During 1985, Plan participants purchased approximately 2.9 million shares by investing nearly \$71 million in dividends and optional payments.

The Company plans to continue the modified Dividend Reinvestment and Stock Purchase Plan as an investment option for its shareholders even though the tax deferral benefits expired at year-end 1985.

New Capital Market Opened

In October, Edison became the first private corporation in the world to sell "Shogun" bonds in Japan. "Shogun" bonds are unsecured debt issued in Japan with interest and principal payable in U.S. dollars rather than in yen. This \$100 million issue will produce meaningful savings for Edison's customers compared with bonds which could have been sold in the United States or Europe at that time. At least as importantly, it introduced Edison to one of the largest and most rapidly growing capital markets in the world as a potential future source of funds for the Company.

Capitalization

The Company's total capitalization at year-end was \$10.2 billion, comprising 45.1 percent Common Equity, 8.5 percent Preferred and Preference Stock, and 46.4 percent Debt.

Corporate Financings

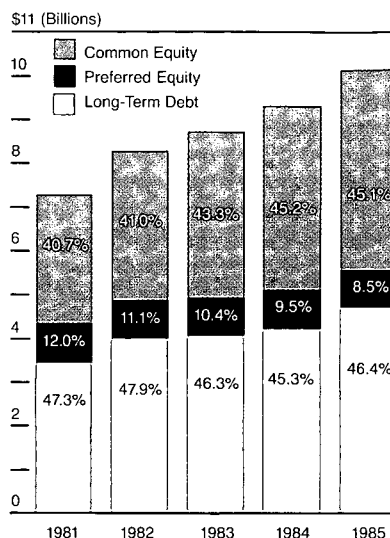
In 1985, Edison completed \$1.1 billion of long-term financings—the largest financing program in the Company's history. Of this amount, \$336 million represented "new money" to finance the construction of new plant and facilities. The remainder was used to replace maturing bonds and to reduce borrowing costs by refinancing debt issued at high interest rates with lower interest rate bonds.

The lowest cost capital raised by the Company in 1985 was \$279 million of tax-exempt bonds issued to finance pollution control equipment at the San Onofre and Palo Verde nuclear plants. The average cost of these funds was about 5 percent.

These tax-exempt financings, combined with the refinancing of high-cost coupon debt, reduced the Company's interest costs, which are reflected in customer rates, by \$27 million annually.

Capital was raised in 1985 through the issuance of debt in the United States, Europe and Japan, and through sales of common stock through the Dividend Reinvestment and Stock Purchase Plan. Details of the Company's 1985 financing activities are set forth in an accompanying table on page 24.

Total Capitalization

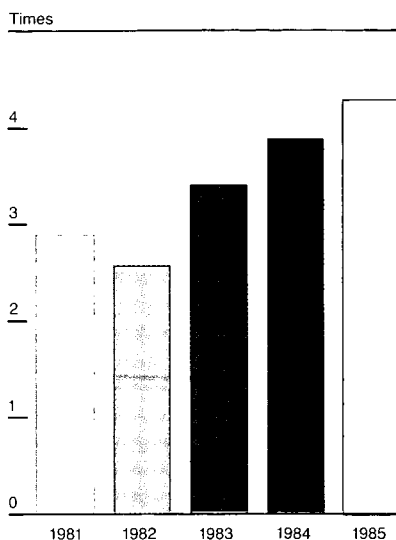


Including the \$336 million of net new capital raised in 1985, the Company's total capitalization at year-end was \$10.2 billion, an 8.2 percent increase over 1984. Edison's capitalization nearly matched the 45 percent/10 percent/45 percent capital structure adopted by the CPUC in the Company's 1985 General Rate Case.



"SHOGUN" SIGNING CEREMONY—Edison's Chairman and Chief Executive Officer Howard P. Allen (center) joins hands with Jiro Yamana (left), senior managing director of Daiwa Securities Co. Ltd., and A. Richard Janiak, managing director of Smith Barney, Harris Upham International Inc., during ceremonies commemorating the issuance of "Shogun" bonds. Edison was the first corporation to sell these Japanese bonds on which the interest and principal are paid in U.S. dollars rather than yen.

Pretax Interest Coverage



Lower interest rates, refunding of high-coupon debt and reduced borrowing needs have created a steady improvement in the Company's pretax interest coverage. This ratio increased to 4.4 times in 1985, the highest level in 20 years.

Future Financings

Improved internal generation of funds has reduced the need for new money to fund Edison's construction program. However, additional financings are planned to replace high-cost debt and preferred stock with new debt at lower rates. In early 1986, the Company purchased \$125 million of its 13% Series 85A mortgage bonds through a tender offer, and announced the redemption of three issues of preferred stock—the \$75 million 12% Series, the \$50 million 9.20% Series, and the \$50 million 8.85% Series. If interest rates remain favorable, Edison plans to continue its high-coupon bond refunding program by calling additional high-coupon debt and replacing it with lower-cost debt.

To finance these needs, the Company will select among the United States, European and Japanese capital markets to find the lowest-cost alternative available to the Company.

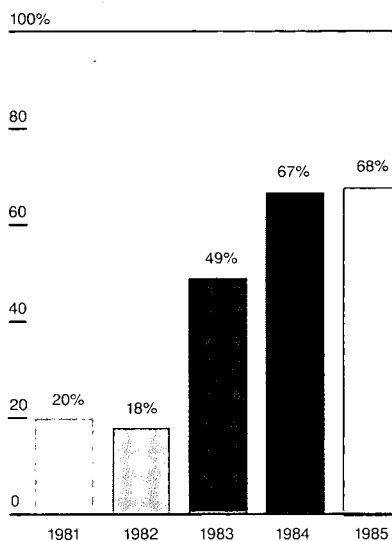
Project Financings

In addition to the \$1.1 billion in Edison financings, Kern River Cogeneration Company, a partnership between an Edison subsidiary, Southern Sierra Energy Company, and a Texaco Inc. subsidiary has thus far raised \$125 million of debt to finance the Omar Hill Cogeneration project.

This financing is not guaranteed by Edison; that is, the lenders look only to the project's assets, not the assets of the partners or their parent companies, as collateral for the financing.

In 1986, Edison subsidiaries expect to participate in similar project financings to fund other alternative energy projects.

Internal Generation of Funds



With major new generating facilities included in customer rates, there has been a substantial improvement in Edison's internal generation of funds. In 1985, the Company met 68 percent of its capital requirements internally, the highest level in more than 25 years.

1985 FINANCING ACTIVITIES

Issue	Term (years)	Amount (millions)
NEW ISSUES		
March		
First and Refunding Mortgage Bonds, Series 85A; 13%	30	\$225
June		
Eurodebenture; 11%	7	100
August		
Pollution Control Revenue Refunding Bonds—Variable Rate; 5.2%	24	144
October		
First and Refunding Mortgage Bonds, Series 85B; 10%	5	125
First and Refunding Mortgage Bonds, Series 85C; 11½%	30	200
November		
Shogun Debenture; 10½%	8	100
Pollution Control Revenue Bonds—Variable Rate; 4.9%	23	135
Ongoing		
Dividend Reinvestment and Stock Purchase Plan		71
		<u>\$1,100</u>
REDEMPTIONS OR RETIREMENTS		
First and Refunding Mortgage Bonds:		
Series L, 5%, due 1985 (Retired)		\$(30)
Series NN, 15¼%, due 2005 (redeemed)		(224)*
Series M, 4¾%, due 1985 (Retired)		(60)
Series OO, 13½%, due 2010 (redeemed)		(167)*
3¾% Series, due 1985 (Retired)		(6)
Pollution Control Revenue Bonds (redeemed)		
1984 Series C; 5.6%		(79)
1984 Series D; 5.6%		(25)
1985 Series A; 5.9%		(41)
Eurodebentures:		
14%, due 1987 (redeemed)		(51)*
14¾%, due 1988 (redeemed)		(51)*
Ongoing		
Sinking Fund Obligations		(30)
		<u>(764)</u>
New Capital Raised in 1985		
		<u>\$ 336</u>

*Includes debt reacquisition expenses.

Regulatory and Legislative Review

San Onofre Units 2 and 3 Reasonableness Review

In May 1985, the Public Staff Division of the CPUC, based on studies by its consultants, recommended that \$760 million of the cost of San Onofre Units 2 and 3 be disallowed from rate base. Subsequent revisions, including the introduction of a unique and unprecedented "risk sharing" proposal, changed the amount of the proposed disallowances three times. The Public Staff is currently recommending that an estimated \$971 million of the \$4.5 billion construction costs of Units 2 and 3 not be allowed to be recovered from customer rates.

Edison's share of the recommended disallowance as a 75 percent owner would be approximately \$729 million.

Of the proposed disallowance, \$536 million, or 55 percent, is based on the Public Staff's 2½-year, three-phase review of the construction of the units. The balance of \$435 million, or 45 percent, is based on the Public Staff's November 1985 recommendation that, in addition to disallowing costs found to have been "unreasonably incurred," all other San Onofre construction costs in excess of \$3.1 billion (the 1975 Edison projection of construction costs) should be shared equally by customers and shareholders.

In response, Edison submitted to the CPUC 30,000 pages of written testimony and supporting documents by Company officers and such nationally recognized experts on energy issues as James R. Schlesinger, former secretary of the Department of Energy (DOE) and former chairman of the Atomic Energy Commission; William D. Ruckelshaus, past administrator of the Environmental Protection Agency; Victor Gilinsky, former commissioner of the NRC; Alfred E. Kahn, former chairman of the New York Public Service Commission; John C. Sawhill, former president of New York University and a former deputy secretary of DOE; Dr. Irwin C. Bupp, director of Cambridge Energy Research Associates, Inc.; and J. Ronald Fox, professor of business administration, Harvard University School of Business Administration.

The Company's testimony identifies serious defects in the analysis by the Public Staff and their consultants and presents a compelling rebuttal of their arguments. As a consequence of the Company's filing, the Public Staff in December acknowledged it had made a fundamental error in its analysis and reduced its specific recommended disallowances from \$830 million to \$536 million.

Edison's filing shows that the units were built to meet the highest standards of safety and environmental protection, and were constructed faster and at less cost than any other two-unit nuclear project completed in recent years. This record was achieved despite record-high interest rates, double-digit inflation, costly and changing regulatory requirements, and unique site constraints and seismic requirements.

Edison firmly believes its testimony demonstrates that the construction of Units 2 and 3 was well managed and the costs incurred were reasonable. However, because the Company cannot forecast the CPUC's ultimate decision on this issue, particularly in light of the Public Staff's "risk-sharing" proposal, the Company's independent public accountants, Arthur Andersen & Co., have qualified its opinion on the Company's financial statements, subject to the outcome of the reasonableness review.

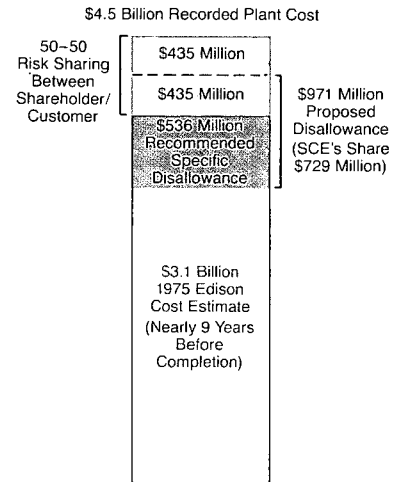
Public hearings at the CPUC are scheduled to continue through May, with a final decision projected in late 1986.

Palo Verde Reasonableness Review

Edison has a 15.8 percent ownership interest in three 1,222-MW units nearing completion at the Palo Verde Nuclear Generating Station near Phoenix, Arizona. Additional participants with ownership interests in Palo Verde include utilities from California, Arizona, New Mexico and Texas. Arizona Public Service Company is the project manager.

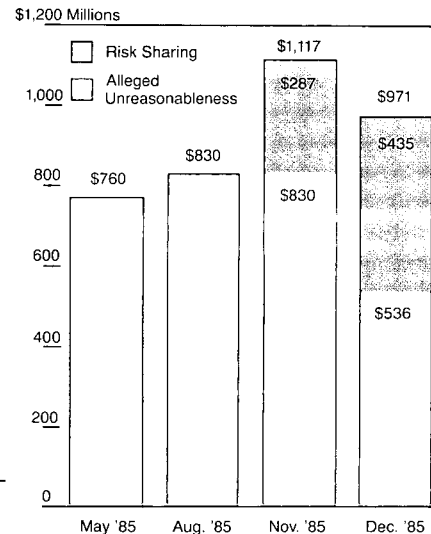
The utility commissions of California, Arizona, New Mexico and Texas have undertaken a joint review of the reasonableness of the construction costs of Palo Verde. This review is scheduled to be completed by early 1987, and public hearings will follow.

San Onofre Units 2 and 3 Proposed Disallowance



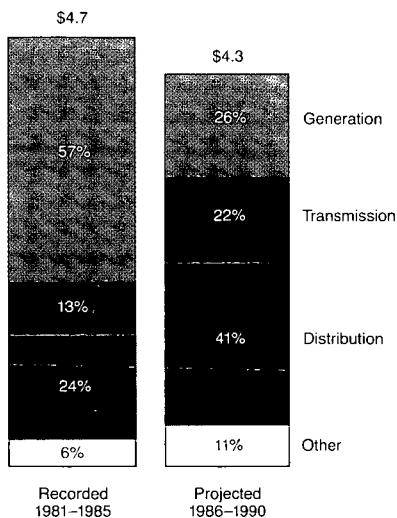
In November 1985, the CPUC Public Staff introduced an unprecedented "risk-sharing" proposal which, in addition to disallowing specific costs, also would split equally between customers and shareholders San Onofre construction costs in excess of a 1975 Edison projection. The Company's share of the total recommended disallowance would be about \$729 million.

CPUC Public Staff's Disallowance Recommendations



Since the CPUC Public Staff's first San Onofre 2 and 3 disallowance recommendation in May 1985, the Staff has revised its recommendation several times. The Staff recently reduced its recommended specific disallowance from \$830 million to \$536 million after Edison's witnesses pointed out fundamental errors in the Staff's analysis.

Funds Required for Construction (\$ Billions)



Edison's construction program over the next five years is estimated to total \$4.3 billion, compared to \$4.7 billion for the past five years. Additionally, the emphasis for construction is expected to shift away from generation plant to the expansion of the Company's transmission and distribution systems.

Palo Verde Ratemaking

Following the Company's filings in May 1985 to recover its costs associated with Palo Verde Unit 1, the CPUC in October 1985 approved an interim ratemaking procedure that will allow the Company to collect revenues equal to the estimated fuel savings generated by Unit 1, which began commercial operation February 1, 1986. The revenue requirements for capital-related costs, as well as operation and maintenance expenses, will accrue in a balancing account until the CPUC decides on the appropriate level of operation and maintenance expenses, ratemaking methods and the conclusion of the review of the reasonableness of construction costs.

In December, the CPUC rejected the recommendation of its Public Staff to use an unconventional ratemaking method for Palo Verde, which the Company had opposed.

Concurrently, the CPUC directed its Public Staff and the Company to investigate other ratemaking methods to fulfill the Commission's objectives of ensuring cost effectiveness, providing incentives for good operating performance, and allocating the plant's capital costs between current and future ratepayers. A decision on the Palo Verde ratemaking method is anticipated in the latter half of 1986.

1986 Rate Adjustment

Effective January 1, 1986, the Company was authorized a \$146.3 million annual revenue increase as an attrition allowance to reflect changes in inflation and capital costs in the years between General Rate Case years. Of that amount, \$54 million is expected to come from a sales increase in 1986, with the remainder covered by a January 1, 1986, rate increase to customers of 1.9 percent, or \$92 million a year.

The increase is subject to refund pending a CPUC review of its overall procedures governing rate relief. The CPUC also is looking at reducing Edison's authorized rate of return on common equity, currently set at 16 percent.

Since 1984, the CPUC has operated on a three-year General Rate Case cycle, instead of a two-year cycle.

San Onofre Unit 1 Rate Request

In response to Edison's earlier filings, the CPUC in December authorized the Company to expend approximately \$200 million to complete NRC-mandated modifications and other improvements to San Onofre Unit 1 during its next three refueling periods.

Edison also requested a \$43 million annual increase in authorized revenues and amortization of approximately \$37 million of previously uncollected revenues, effective May 1, 1986, to reflect in rates the expenditures for these modifications. The application also requested a CPUC finding that \$194 million in replacement energy costs were reasonably incurred when Unit 1 was out of service for upgrades from February 1982 through November 1984.

Decisions on the rate-related issues are expected in 1986 and 1987.

San Onofre Unit 1 Repair Costs for Steam Generators

On March 20, the CPUC ordered Edison to stop the annual collection through rates of approximately \$13.3 million associated with the repair of steam generators at San Onofre Unit 1 and to set aside these expenses in a separate account. The CPUC indicated that it would determine whether, at a later date, the Company could recover these repair expenses through customer rates.

In December the CPUC issued an order to show cause to determine whether the Company should be required to refund to customers the \$16 million of repair expenses already collected and permanently forego collection of the \$24 million of remaining expenses. The Company has responded to the CPUC order, and a decision by the CPUC is anticipated in early 1986.

Energy Cost Rate Request

In 1985, the Company requested a \$290 million annual rate increase under its Energy Cost Adjustment Clause (ECAC), primarily to reflect increased fuel and purchased power costs, and to provide for amortization of various balancing accounts. In December, the CPUC determined that Edison should

recover its fuel oil inventory costs based on short-term interest rates, rather than its authorized cost of capital. This action reduced the Company's ECAC filing by approximately \$40 million, bringing the energy-related rate increase request to \$250 million annually. A decision is expected in the near future.

Resale Customer Rate Increase

Edison sells electricity to six Southern California cities (Anaheim, Azusa, Banning, Colton, Riverside and Vernon), the Southern California Water Company and the Arizona Public Service Company under rates subject to Federal Energy Regulatory Commission (FERC) approval. Recently, for the first time in many years, the Company reached a rate settlement with these six resale cities that also was acceptable to the other two resale customers, making it unnecessary for the Company to file a 1986 general rate case with FERC. Under the settlement, Edison will increase its rates to these customers by about 2 percent, producing total estimated revenues of \$260 million annually. A decision by FERC on this settlement is expected in April.

Five general rate cases requesting increases for 1976, 1979, 1981, 1982 and 1984 currently are being litigated and remain unresolved. Major issues include the proper level of expenses to be reflected in rates, the appropriate rate of return on common equity to be authorized, and how revenues should be allocated among the various customers.

Hydro Relicensing

Edison and other investor-owned utilities throughout the nation continued to face the threat of unfairly losing federally licensed hydroelectric plants that they constructed and operated for many years. This would deprive customers of their right to receive the benefits of low-cost power from these hydro projects.

The Company's position is that the 1920 Federal Power Act does not give preference to municipally owned utilities when they are competing against investor-owned utilities in hydro

relicensing cases. Not only would this preference be unjust and inequitable, it also would result in higher rates for Edison's customers. A transfer of ownership from one group of taxpayers to another would unfairly benefit municipally owned utilities, which serve only a small fraction of the customers served by Edison.

The Company believes that the millions of customers who originally paid for the facilities should continue to receive the benefits. The loss of Edison's hydro facilities would require the purchase or production of more costly replacement power, thereby increasing customer rates.

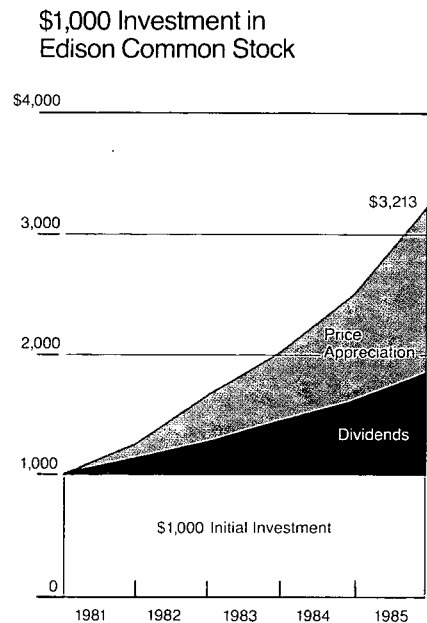
To avoid this possibility, Edison and other investor-owned utilities are supporting the enactment of legislation in the U.S. Congress to protect their customers' rights. During 1985, there was considerable progress toward enacting legislation in both the U.S. Senate and House of Representatives that will resolve the issue in a fair manner in 1986.

Federal Tax Legislation

Early in 1985 the President proposed major changes to the federal tax system, including repeal of the Investment Tax Credit, changes in depreciation and changes to the treatment of employee benefits. Certain of these changes would not be in the best interests of Edison's shareholders, customers and employees, and the Company worked to obtain more favorable legislation.

In December the House passed tax reform legislation which greatly modified the President's proposal, but still left many provisions that would have a negative impact on the Company, its customers and employees.

The Senate is expected to pass its version of the tax bill in 1986, and the final legislation will be resolved by a joint House-Senate Conference Committee. The Company will continue to seek amendments to the proposed legislation that will take into account the national interest, while treating equitably the interests of Edison's shareholders, customers and employees.



Through dividends and price appreciation, Edison common stock has provided a compound return to investors of 26 percent annually over the past five years. Assuming reinvestment of dividends, a \$1,000 investment in Edison common stock at the beginning of 1981 would have grown over three times by year-end 1985.

Responsibility for Financial Statements

The management of Southern California Edison Company has prepared and is responsible for the financial statements and the other related financial data contained in this Annual Report. The financial statements, which include amounts based on estimates and judgments of management, have been prepared in conformity with generally accepted accounting principles applied on a consistent basis.

To meet its responsibilities with respect to financial information, the Company maintains a system of internal accounting controls which is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and that the financial records properly reflect the authorized transactions of the Company. This system is supported by written policies and procedures, organization structures that provide for appropriate division of responsibility and the selection and training of qualified personnel and is augmented by programs of internal audits. There are limits inherent in all systems of internal accounting control based on the recognition that the cost of such systems should not exceed the benefits to be derived. The Company believes its system of internal accounting control appropriately balances this cost-benefit relationship.

An independent examination of these financial statements has been conducted by Arthur Andersen & Co., independent public accountants, in accordance with generally accepted auditing standards. In connection therewith,

the independent accountants develop and maintain an understanding of the Company's accounting and financial controls, and conduct such tests and related procedures as they deem necessary to render their opinion as to the fairness of the financial statements.

The Audit Committee of the Board of Directors, composed entirely of directors who are not officers or employees of the Company, meets periodically with the management of the Company, the independent public accountants and the internal auditors to make inquiries as to the manner in which the responsibilities of each are being discharged. In addition, the Audit Committee recommends to the Board of Directors the annual appointment of the independent public accountants with whom the Audit Committee reviews the scope of the audit and the nature of other services provided as well as the related fees, the accounting principles being applied by the Company in financial reporting, the scope of internal financial auditing procedures, and the adequacy of internal accounting controls.

To further assure independence in performing and reporting the results of audits, representatives of the independent public accountants and the Company's staff of internal auditors have full and free access to meet with the Audit Committee, without members of Company management being present, to discuss any accounting, auditing, or financial reporting matter.

Report of Independent Public Accountants

To the Shareholders and the Board of Directors,
Southern California Edison Company:

We have examined the balance sheets and statements of capitalization of Southern California Edison Company (a California corporation, hereinafter referred to as the "Company"), as of December 31, 1985 and 1984 and the related statements of income, common shareholders' equity and sources of funds used for construction expenditures for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed further in Note 2, the California Public Utilities Commission (CPUC) Public Staff has issued a series of reports which recommend disallowances of certain construction costs related to San Onofre Nuclear Generating Station Units 2 and 3, of which the Company owns a 75.05 percent undivided interest. A CPUC decision on this matter is not expected before late 1986. The Company has concluded that it is not possible to determine the probable financial effect that the final outcome of the

CPUC reasonableness review will have on the Company's financial position and results of operations.

In our opinion, subject to the effects on the balance sheets and statements of capitalization as of December 31, 1985 and 1984 and the statements of income, common shareholders' equity and sources of funds used for construction expenditures for the years ended December 31, 1985 and 1984 of such adjustments, if any, as might have been required had the outcome of the matter referred to in the preceding paragraph been known, the financial statements referred to above present fairly the financial position of the Company as of December 31, 1985 and 1984 and the results of its operations and the sources of its funds used for construction expenditures for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.



Los Angeles, California,
February 7, 1986

ARTHUR ANDERSEN & CO.

Statements of Income

Year Ended December 31,

1985

1984

1983

	(In Thousands)		
Operating Revenues:			
Sales (Notes 1, 2 and 10)	\$5,141,735	\$4,842,959	\$4,413,619
Other	27,113	56,193	50,637
Total operating revenues	5,168,848	4,899,152	4,464,256
Operating Expenses:			
Fuel (Note 2)	1,683,363	1,478,236	1,457,102
Purchased power (Note 8)	705,724	606,705	570,654
Provisions for regulatory adjustment clauses (Note 1)	(607,036)	(460,337)	(21,559)
Other operating expenses (Note 8)	755,325	728,625	604,694
Maintenance	352,635	419,458	279,916
Depreciation (Note 1)	454,574	398,623	289,361
Income taxes (Note 4)	720,938	639,875	497,236
Property and other taxes	130,571	121,342	82,821
Total operating expenses	4,196,094	3,932,527	3,760,225
Operating Income	972,754	966,625	704,031
Other Income:			
Allowance for equity funds used during construction (Note 1)	123,179	145,967	268,831
Interest income	83,867	67,601	33,272
Taxes on non-operating income—credit (Note 4)	11,928	29,666	117,160
Other income and income deductions—net	35,664	4,071	9,838
Total other income	254,638	247,305	429,101
Total Income Before Interest Charges	1,227,392	1,213,930	1,133,132
Interest Charges:			
Interest on long-term debt	418,515	442,987	425,075
Other interest and amortization (Note 1)	69,285	87,335	114,302
Total interest charges	487,800	530,322	539,377
Allowance for borrowed funds used during construction (Note 1)	(34,515)	(48,820)	(97,025)
Net interest charges	453,285	481,502	442,352
Net Income	774,107	732,428	690,780
Dividends on Cumulative Preferred and Preference Stock	71,698	73,043	73,477
Earnings Available for Common and Original Preferred Stock	\$ 702,409	\$ 659,385	\$ 617,303
Weighted-Average Shares of Common and Original Preferred Stock Outstanding (000)	215,649	207,576	198,348
Earnings Per Share	\$3.26	\$3.18	\$3.11
Dividends Declared Per Common Share	\$2.13	\$2.01	\$1.83

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

Balance Sheets	Assets	At December 31,	1985	1984
			(In Thousands)	
Utility Plant:				
Utility plant, at original cost (Notes 1 and 6)			\$11,853,442	\$10,905,719
Less—Accumulated depreciation (Notes 1 and 6)			3,152,141	2,763,651
			8,701,301	8,142,068
Construction work in progress (Notes 1 and 6)			2,041,738	1,849,204
Nuclear fuel, at amortized cost			95,180	80,108
			10,838,219	10,071,380
Less—Property-related accumulated deferred income taxes (Notes 1 and 4)			531,746	386,515
Total utility plant			10,306,473	9,684,865
Other Property and Investments:				
Nonutility property and other investments, at cost—less accumulated depreciation . . .			38,501	19,470
Special funds (Note 1)			24,326	79,888
Investments in and advances to subsidiaries (Note 1)			162,786	116,584
Total other property and investments			225,613	215,942
Current Assets:				
Cash and equivalents (Note 3)			37,757	68,916
Cash investments—financing subsidiary (Note 1)			163,979	153,088
Receivables, less reserves of \$9,833,000 and \$10,400,000 for uncollectible accounts at respective dates			351,095	371,550
Fuel stock, at cost (first-in, first-out)			255,508	404,378
Materials and supplies, at average cost			106,178	111,967
Regulatory balancing accounts—net (Notes 1 and 2)			792,011	18,355
Accumulated deferred income taxes—net (Note 4)			—	1,027
Prepayments and other			100,663	78,722
Total current assets			1,807,191	1,208,003
Deferred Charges:				
Unamortized debt issuance and reacquisition expense (Note 1)			144,977	92,987
Accumulated deferred income taxes—net (Note 4)			—	80,709
Other deferred charges			109,195	76,224
Total deferred charges			254,172	249,920
Total Assets			\$12,593,449	\$11,358,730

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

Capitalization and Liabilities

At December 31,

1985

1984

(In Thousands)

Capitalization:

Common stock, at par value, 216,676,897 and 212,552,728 shares outstanding at respective dates	\$ 902,821	\$ 885,637
Additional paid-in capital	1,543,933	1,470,347
Earnings reinvested in the business	2,128,646	1,886,804
Common shareholders' equity	4,575,400	4,242,788
Preferred and preference stock without mandatory redemption requirements	466,500	467,258
Preferred and preference stock with mandatory redemption requirements	395,074	422,286
Long-term debt (Note 1)	4,717,411	4,248,647
Total capitalization	10,154,385	9,380,979

Long-term Obligations:

Accumulated provisions for pensions, insurance, etc. (Note 5)	91,126	75,028
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Current Liabilities:

Preferred and preference stock to be redeemed within one year	20,463	18,213
Long-term debt due within one year	45,110	101,250
Short-term borrowings (Note 3)	15,000	—
Short-term borrowings—financing subsidiary (Notes 1 and 3)	148,850	141,950
Accounts payable	401,489	395,484
Accrued taxes (Note 4)	233,722	236,375
Accrued interest	110,394	117,447
Dividends payable	122,347	113,790
Accumulated deferred income taxes—net (Note 4)	391,781	—
Other	106,240	66,145
Total current liabilities	1,595,396	1,190,654

Deferred Credits:

Accumulated deferred investment tax credits (Note 4)	485,614	399,019
Accumulated deferred income taxes—net (Note 4)	32,062	—
Customer advances and other deferred credits	234,866	313,050
Total deferred credits	752,542	712,069

Commitments and Contingencies (Notes 2, 7, 8 and 9)

Total Capitalization and Liabilities	\$12,593,449	\$11,358,730
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The accompanying notes are an integral part of these financial statements.

**Statements of Sources of Funds
Used for Construction Expenditures**

 Year Ended December 31, **1985** 1984 1983

FUNDS PROVIDED BY—

(In Thousands)

Operations:

Net income	\$ 774,107	\$ 732,428	\$690,780
Items in net income not affecting working capital—			
Depreciation	454,574	398,623	289,361
Allowance for borrowed and equity funds used during construction	(157,694)	(194,787)	(365,856)
Deferred income taxes	192,575	174,496	119,722
Investment tax credits deferred—net	84,134	55,323	69,416
Other—net	5,102	40,408	82,168
Total funds provided by operations	1,352,798	1,206,491	885,591
Dividends	(532,265)	(492,049)	(438,135)
Total funds provided by operations—reinvested	820,533	714,442	447,456

Long-term Financing:

Sales of securities—			
Common stock	90,770	209,321	147,799
Long-term debt	1,111,880	627,860	130,848
Reduction for preferred and preference stock to be redeemed within one year	(20,463)	(18,213)	(4,500)
Conversion of preference stock	(758)	(1,764)	(1,995)
Increase in other long-term debt	—	2,638	26,099
Reduction for long-term debt due within one year	(45,110)	(101,250)	(83,000)
Refunding and early retirement of preferred stock and long-term debt	(653,632)	(403,896)	—
Total funds provided by long-term financing	482,687	314,696	215,251
Total funds provided	1,303,220	1,029,138	662,707

OTHER SOURCES (USES) OF FUNDS—
Working capital changes:

Cash and equivalents and cash investments	20,268	189,669	(163,163)
Receivables—net	20,455	(70,859)	5,350
Fuel stock, materials and supplies	154,659	5,835	147,167
Accumulated deferred income taxes—net	392,808	216,663	(18,751)
Preferred and preference stock and long-term debt due within one year	(53,890)	31,963	29,500
Net short-term borrowings	21,900	(56,020)	50,678
Accounts payable	6,005	31,028	(46,784)
Accrued taxes	(2,653)	(71,028)	141,264
Regulatory balancing accounts—net	(773,656)	(394,603)	6,931
Other changes in working capital	19,658	(9,910)	20,135
Net (increase) decrease in working capital	(194,446)	(127,262)	172,327

Fuel contract settlement payments, net

of deferred taxes	(62,402)	—	—
Special funds and other—net	30,123	(49,602)	(29,537)

Total other sources (uses) of funds

.....	(226,725)	(176,864)	142,790
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Funds Used for Construction Expenditures	\$1,076,495	\$ 852,274	\$805,497
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The accompanying notes are an integral part of these financial statements.

Statements of Capitalization	December 31, 1985		December 31,	
	Shares Outstanding	Redemption Price	1985	1984
			(In Thousands)	
Common Shareholders' Equity —detailed on page 34	216,676,897	—	\$ 4,575,400	\$4,242,788
Preferred and Preference Stock —without mandatory redemption requirements (a)(b):				
Original Preferred—5%, prior, cumulative, participating, not redeemable, par value \$8⅓ per share	480,000	—	4,000	4,000
Cumulative Preferred—par value \$25 per share (i):				
4.08% Series	1,000,000	\$ 25.50	25,000	25,000
4.24% Series	1,200,000	25.80	30,000	30,000
4.32% Series	1,653,429	28.75	41,336	41,336
4.78% Series	1,296,769	25.80	32,419	32,419
5.80% Series	2,200,000	25.25	55,000	55,000
8.85% Series	2,000,000	25.75	50,000	50,000
9.20% Series	2,000,000	25.75	50,000	50,000
\$100 Cumulative Preferred—par value \$100 per share:				
7.58% Series	750,000	102.50	75,000	75,000
8.70% Series	500,000	104.00	50,000	50,000
8.96% Series	500,000	104.00	50,000	50,000
Preference—par value \$25 per share (b):				
5.20% Convertible Series	149,782	25.00	3,745	4,503
\$100 Preference—par value \$100 per share	—	—	—	—
Total Preferred and Preference Stock—without mandatory redemption requirements			466,500	467,258
Preferred and Preference Stock —with mandatory redemption requirements (a)(c):				
\$100 Cumulative Preferred—par value \$100 per share:				
7.325% Series	660,000	\$104.29	66,000	69,000
7.80% Series	554,995	110.00	55,499	56,999
8.54% Series	682,500	105.65	68,250	75,000
8.70% Series A	511,874	110.00	51,188	52,500
12.00% Series	750,000	108.33	75,000	75,000
12.31% Series	500,000	105.83	50,000	50,000
Preference—par value \$25 per share: 7.375% Series	1,984,000	25.00	49,600	62,000
Preferred and Preference Stock to be redeemed within one year			415,537	440,499
Total Preferred and Preference Stock—with mandatory redemption requirements			(20,463)	(18,213)
			395,074	422,286
Long-term Debt —		Interest Rates		
First and Refunding Mortgage Bonds (d)(e)(f)(i):				
Due 1986 through 1989		4¼%–9⅝%	290,000	562,050
Due 1990 through 1994		4½%–15¼%	895,000	770,000
Due 1995 through 1999		7%–8¼%	440,030	440,030
Due 2000 through 2004		8¼%–11¾%	1,007,750	1,007,750
Due 2005 through 2021		9%–16%	1,092,037	1,017,269
First Mortgage Bonds (Calectric)(d)(e)				
Due 1986 through 1991		4½%–5⅝%	46,000	52,000
Debentures				
Due 1992 through 1993		10½%–11%	200,000	—
Promissory Notes (b)(e)(g)				
Due 1989 through 1997		11%–15½%	233,958	352,304
Pollution Control Indebtedness (f)				
Due 2008 through 2009		Variable	575,400	440,400
Other long-term debt (e)(h)			28,657	28,737
Principal amounts outstanding			4,808,832	4,670,540
Long-term debt due within one year—net (e)			(45,110)	(101,250)
Unamortized debt premium or (discount)—net			(11,364)	(17,041)
Securities held by trustees (f)			(34,947)	(303,602)
Total Long-term Debt			4,717,411	4,248,647
Total Capitalization			\$10,154,385	\$9,380,979

Notes to Statements of Capitalization are on page 35.

Statements of Common Shareholders' Equity

1985

1984

1983

(In Thousands)

Common Stock —par value \$4 $\frac{1}{8}$ per share, 280,000,000 shares authorized, 216,676,897, 212,552,728 and 201,480,310 outstanding at December 31, of respective years (a)(b):	<u>\$ 902,821</u>	<u>\$ 885,637</u>	<u>\$ 839,501</u>
Additional Paid-in Capital:			
Balance at January 1	<u>\$1,470,347</u>	\$1,307,413	\$1,193,318
Premium received on sale of Common Stock and conversions (a)(b):	<u>73,652</u>	163,774	114,228
Capital stock expense	<u>(66)</u>	(840)	(133)
Additional Paid-in Capital at December 31,	<u>\$1,543,933</u>	<u>\$1,470,347</u>	<u>\$1,307,413</u>
Earnings Reinvested in the Business:			
Balance at January 1	<u>\$1,886,804</u>	\$1,646,425	\$1,393,780
Add:			
Net income	<u>774,107</u>	732,428	690,780
	<u>2,660,911</u>	<u>2,378,853</u>	<u>2,084,560</u>
Less:			
Dividends declared on capital stock—			
Common—\$2.13 per share for 1985 and \$2.01 per share for 1984 and \$1.83 per share for 1983	<u>458,551</u>	417,115	362,935
Original Preferred	<u>2,016</u>	1,891	1,723
Cumulative Preferred	<u>67,676</u>	68,203	68,540
Preference	<u>4,022</u>	4,840	4,937
	<u>532,265</u>	492,049	438,135
Earnings Reinvested at December 31, (c)	<u>\$2,128,646</u>	<u>\$1,886,804</u>	<u>\$1,646,425</u>
Total Common Shareholders' Equity at December 31,	<u>\$4,575,400</u>	<u>\$4,242,788</u>	<u>\$3,793,339</u>

Notes to Statements of Common Shareholders' Equity are on page 35.

Notes to Statements of Capitalization—

(a) As of December 31, 1985, authorized shares for the Original Preferred, \$25 Cumulative Preferred, \$100 Cumulative Preferred, \$25 Preference and \$100 Preference Stock were 480,000, 24,000,000, 12,000,000, 10,000,000, and 2,000,000 shares, respectively. All series of Cumulative Preferred, \$100 Cumulative Preferred and Preference Stock are redeemable at the option of the Company. The 500,000 shares of \$100 Cumulative Preferred Stock, 12.31% Series, are not subject to such redemption until May 1, 1992. The various series of \$100 Cumulative Preferred Stock, and the Preference Stock, 7.375% Series, are subject to certain restrictions on redemption for refunding purposes.

(b) As of December 31, 1985, the conversion price of the Preference Stock, 5.20% Convertible Series was \$15.75 per share. The 12½% Convertible Subordinated Debentures Due 1997, issued by Southern California Edison Finance Company N.V., are convertible into Company common stock at the conversion price of \$16.1875 per share.

(d) Substantially all of the properties of the Company are subject to the liens of Trust Indentures.

(e) Maturities and sinking fund requirements of long-term debt for the five years subsequent to December 31, 1985 are as follows:

Year Ended December 31,	Sinking Fund		
	Maturities	Requirements	Total
	(In Thousands)		
1986	\$ 39,860	\$5,250	\$ 45,110
1987	148,065	5,250	153,315
1988	74,292	5,250	79,542
1989	137,544	5,250	142,794
1990	349,823	5,725	355,548

Notes to Statements of Common Shareholders' Equity—

(a) At December 31, 1985, shares of Common Stock reserved for issuance were as follows:

	Shares
Conversion of Preference Stock, 5.20% Convertible Series	237,755
Conversion of 12½% Convertible Subordinated Debentures, Due 1997, Issued by Southern California Edison Finance Company N.V.	664,588
Stock purchase plans	4,238,575*
Total	<u>5,140,918</u>

(c) For Preferred and Preference Stock with Mandatory Redemption Requirements, the aggregate mandatory redemption requirements for the five years subsequent to December 31, 1985 are as follows:

	No. of Shares	Commencing	1986	1987	1988	1989	1990
			(In Thousands)				
\$100 Cumulative Preferred							
7.325%	30,000	7/31/83	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,000
7.80%	15,000*	11/30/83	1,500	1,500	1,800	1,800	1,800
8.54%	22,500**	6/30/86	—	—	—	2,250	2,250
8.70%A	13,125	6/30/85	1,313	1,313	1,313	1,313	1,313
12.00%	22,500***	12/31/86	2,250	2,250	2,250	2,250	2,250
12.31%	35,000****	4/30/88	—	—	3,500	3,500	3,375
Preference							
7.375%	496,000	2/01/85	12,400	12,400	12,400	12,400	—
			<u>\$20,463</u>	<u>\$20,463</u>	<u>\$24,263</u>	<u>\$26,513</u>	<u>\$13,988</u>

*Increases to 18,000 shares beginning in 1988.
**67,500 shares were redeemed in 1985.
***12.00% series are to be redeemed on February 28, 1986.
****Decreases to 33,750 shares beginning in April 1990.

(f) First and Refunding Mortgage Bonds and other indebtedness have been issued to governmental agencies in exchange for the proceeds from the issuance of Pollution Control Revenue Bonds and Pollution Control Revenue Refunding Bonds. The proceeds have been deposited with Trustees and are being utilized to defray the construction and other specified costs of pollution control facilities and retirement of maturing issues. Such Bonds may be redeemed at the election of the Bond holders. The Company has entered into agreements with security dealers which provide for the remarketing or purchase of the Bonds when such elections are made.

(g) Promissory Notes payable to Southern California Edison Finance Company N.V. (Finance) have been issued in exchange for the proceeds from the issuance of Debentures by Finance. Payment of the principal and interest on \$225,000,000 and \$8,958,000 principal amount of the Debentures are, respectively, unconditionally guaranteed and

guaranteed on a subordinated basis by the Company. The Subordinated Debentures are convertible into the Company's Common Stock.

(h) Pursuant to the Nuclear Waste Policy Act of 1982 (Act), the Company has entered into a contract with the U.S. Department of Energy for disposal of spent nuclear fuel for the San Onofre Nuclear Generating Station. The weighted-average interest rates used for the years ended December 31, 1985 and 1984 were 9.74% and 9.63%, respectively.

(i) The \$25 Cumulative Preferred Stock, 8.85% and 9.20% Series, are planned to be redeemed on March 4, 1986. During January and February 1986, the Company reacquired through a tender offer and an open-market purchase approximately \$125,000,000 principal amount of First and Refunding Mortgage Bonds, Series 85A, Due 2015. Related debt reacquisition expenses of approximately \$23,500,000 were incurred.

Shares Issued	1985	1984	1983
DRP	2,942,754	5,389,210	4,657,988
SSPP	—	2,954,346	1,907,422
ESOP	—	1,214,803	1,404,400
5.20% Series	48,090	112,015	126,554
12½% Convertible Debentures	1,133,325	1,402,044	—

(c) Includes undistributed earnings of unconsolidated subsidiaries of \$26,165,000 and appropriated reinvested earnings related to certain federally-licensed hydroelectric projects of \$4,274,000 at December 31, 1985.

Notes to Financial Statements

NOTE 1—Summary of Significant Accounting Policies

General—

The accounting records of the Company are maintained in accordance with the Uniform System of Accounts as prescribed by the Federal Energy Regulatory Commission (FERC) and adopted by the California Public Utilities Commission (CPUC).

Utility Plant—

The cost of additions and replacements of units of property is capitalized and included in utility plant. The original cost, less net salvage, of retired property units is charged to accumulated depreciation. The cost of minor additions and repairs is charged to maintenance expense.

An allowance for borrowed and equity funds used during construction (AFUDC) is included as a cost of construction. The amount of AFUDC capitalized is also reported in the Statements of Income as a reduction of interest charges for the borrowed funds component of AFUDC and as other income for the equity funds component. Although AFUDC increases net income, it does not represent current cash earnings. The AFUDC rate, which is based upon a formula prescribed by the FERC, was 10.40%, 10.24% and 9.95% for 1985, 1984 and 1983, respectively.

Property-related accumulated deferred income taxes are deducted from utility plant. This treatment is consistent with the ratemaking method used to determine rate base.

Depreciation—

For financial reporting purposes, depreciation of utility plant is computed on a straight-line remaining life basis and approximated 4.1%, 4.2% and 4.1%, of average depreciable plant for the years 1985, 1984 and 1983, respectively. The Company's rates are designed to recover the original cost of utility plant, including the estimated decommissioning cost for the San Onofre Nuclear Generating Station (San Onofre) through depreciation expense over the estimated remaining useful lives of the facilities. As of December 31, 1985, rates reflected the estimated decommissioning cost of \$299,226,000 applicable to San Onofre Units 1, 2 and 3.

Special Funds—

Restrictions have been placed on a portion of the proceeds from certain pollution control indebtedness pursuant to conditions in the related tax-exempt loan agreement. The loan conditions require such proceeds to be utilized for the redemption of indebtedness incurred during the period in which the pollution control facilities were constructed.

Research and Development—

Research and Development (R&D) costs are expensed currently if they are of a general nature. Plant-related R&D costs are accumulated in construction work in progress until a determination is made as to whether such projects will result in construction of electric plant. If no construction of electric plant ultimately results, the costs are charged to expense.

	Year Ended December 31, 1985	1984	1983
	(In Thousands)		
R&D costs charged to expense	\$44,139	\$35,843	\$32,588
R&D costs deferred/capitalized	1,030	3,946	11,687
Total R&D expenditures	<u>\$45,169</u>	<u>\$39,789</u>	<u>\$44,275</u>

Income Taxes—

Accounting policies with respect to taxes are set forth in Note 4.

Unamortized Debt Issuance and Reacquisition Expense—

Debt premium, discount, and related issuance expenses are amortized over the lives of the issues to which they pertain. Reacquisition expenses, including unamortized premium, discount and issuance expense associated with the retired indebtedness, are amortized over the remaining lives of the retired indebtedness when reacquired without refunding and over the lives of the new debt issues when reacquired with refunding. Such expenses are being recovered in rates. The Company recorded approximately \$52,250,000 and \$61,150,000 associated with debt reacquisition expenses during 1985 and 1984, respectively.

Revenues and Regulatory Balancing Accounts—

Revenues are recorded when customers are billed. As authorized by the CPUC, the Company has established regulatory balancing accounts which remove the effect on earnings of fluctuations in kilowatt-hour sales, fuel and purchased power costs and certain conservation program expenses. An Electric Revenue Adjustment Mechanism records the differences between authorized and recorded base rate revenues caused by, among other things, fluctuations in kilowatt-hour sales levels. An Energy Cost Adjustment Clause (ECAC) balancing account is used to record monthly entries to adjust the results of operations for variations between 90% of recorded fuel and purchased power costs and those recovered through rates. Such variations are deferred and accumulated in the balancing account until they are refunded to, or recovered from, utility customers through CPUC-authorized rate adjustments. Effective January 1, 1986, the ECAC balancing account includes

a fuel oil inventory carrying charge based on short-term debt interest rates, while for prior years such carrying charges were based on the Company's earned rate of return on rate base. The Company has been authorized Annual Energy Rate (AER) revenues to recover the remaining 10% of forecasted fuel and purchased power costs. On May 15, 1985, the CPUC issued an interim rate order in which the AER component of fuel costs was temporarily reduced to 2%. The AER is expected to be returned to 10% during 1986. The ECAC balancing account is also used to record monthly entries to adjust the results of operations for variations between AER costs and AER revenues in excess of \$30,299,000 on an annualized basis as of December 31, 1985.

The CPUC has established a performance incentive plan for San Onofre Units 2 and 3 which sets a target capacity factor range of 55% to 80%. The fuel savings or costs for operations above or below the target capacity factor range are divided equally between the Company's shareholders and customers.

A Major Additions Adjustment Clause (MAAC) authorized the Company to include in rates the cost of owning and operating San Onofre Units 2 and 3. Under MAAC, a balancing account is utilized to record differences in investment-related costs and rates authorized by the CPUC to recover such costs.

Interest is accrued on the regulatory balancing accounts at the most recent three-month prime commercial paper rate as published by the Federal Reserve. The implicit weighted-average interest rates used for the years 1985 and 1984 were 8.12% and 10.09%, respectively. The income tax effects of the changes in the regulatory balancing accounts are deferred.

Subsidiaries—

The Company's investments in unconsolidated subsidiary companies are accounted for by the equity method except for the Company's subsidiaries engaged in Eurodebenture financings. For these subsidiaries, cash investments and short-term borrowings are presented separately on the balance sheet of the Company. The Company's other subsidiaries are not considered significant for financial reporting purposes.

Reclassifications—

Certain items have been reclassified in prior periods to make them comparable to the classifications at December 31, 1985.

NOTE 2—Regulatory Matters

San Onofre Units 2 and 3—

Rate Treatment and Proposed Disallowance—

When San Onofre Units 2 and 3 were placed in commercial operation in 1983 and 1984, the CPUC did not authorize the Company to recover through customer rates the full cost of these units. Instead, the CPUC authorized the recovery of a portion of costs in customer rates and directed the Company to accrue in a MAAC balancing account the portion of revenues not included in rates. As of December 31, 1985, approximately \$458 million of revenues have been recorded in the MAAC balancing account. These revenues have been included in reported earnings but not collected from customers. Amounts accrued in the MAAC balancing account represent an asset on the Company's balance sheet. When reflected in rates and recovered from customers, revenues previously accrued in the MAAC balancing account affect the Company's cash flow, but not its reported earnings. If rate recovery is denied by the CPUC for any amounts included in the MAAC balancing account, a write-off against income would be required.

Effective January 1, 1985, the CPUC granted the Company's request for a \$300 million annual increase in rates to fully reflect the Company's ownership costs for San Onofre Units 2 and 3. The total authorized customer rates for these units now approximates the investment-related costs.

The CPUC is reviewing the Company's investment in San Onofre Units 2 and 3 to determine the reasonableness of construction costs for rate recovery purposes. The Company's share of the total costs for these units is approximately \$3.4 billion.

Since their initial report in May 1985, the CPUC Public Staff has made three revisions to their recommended amount of disallowance of San Onofre Units 2 and 3 construction costs. Most recently the Public Staff reduced their recommended disallowance of the Company's share of construction costs from \$839 million to \$729 million. Approximately \$402 million of the recommended disallowance is based on consultant reviews. The remaining \$327 million of recommended disallowance is based on a "risk sharing" concept introduced by the Public Staff on November 1 which would establish a 1975 Company project cost estimate as the benchmark for rate recovery of construction costs. Under the "risk sharing" concept, costs in excess of the 1975 project cost estimate, after reduction for the recommended \$402 million disallowance based on consultant reviews, would be shared equally by ratepayers and shareholders.

A finding by the CPUC that a portion of the Company's investment in these units is "unreasonable" would result in the disallowance of costs from the Company's rate base. The Company would be precluded from recovering and earning a return on such disallowed costs.

The Company believes the construction process and costs at San Onofre Units 2 and 3 were reasonable and well managed and has submitted extensive evidence, including the testimony of nationally known and highly respected experts in the fields of nuclear power and regulation, to demonstrate this fact. The Company vigorously supports this position and opposed the CPUC Public Staff's recommendations during hearings which commenced in December 1985 before the CPUC. A CPUC decision on the reasonableness issues is not expected before late 1986.

Under generally accepted accounting principles currently in effect, amounts excluded from rate base are not generally written off as a charge against income at the time of disallowance, but are depreciated over the remaining service life of the facility. Only when the disallowance is so large that allowed rates will be inadequate to recover the total costs of the facility is the unrecoverable investment written off as a charge against income. However, the Financial Accounting Standards Board (FASB) has proposed amendments to its accounting standards for several regulatory-related accounting issues, including a regulator's partial disallowance of construction costs for operating plants. The FASB proposed accounting for partial cost disallowances is to require an immediate write-off of any construction costs excluded from rate base. Because of this proposal, there is uncertainty regarding whether current accounting standards will apply to any San Onofre disallowances which may be imposed. The FASB expects its reconsideration of regulatory accounting issues to be completed during 1986.

If the CPUC adopts a substantial portion of the Public Staff's recommended rate base disallowance and if the FASB changes the principle of accounting to require an immediate write-off of such amount, the adverse financial impact of such disallowance would be material to the Company's financial condition and also would result in a material charge against earnings. Moreover, even if existing accounting standards are not revised, should the CPUC adopt a substantial portion of the Public Staff's recommended rate base disallowance, a material charge against earnings would result at the time of such disallowance because the portion of revenues associated with

the disallowed costs previously included in reported earnings would have to be written off.

In light of the circumstances described above, including the frequent change in the Public Staff's recommendations, the unique nature of its "risk sharing" proposal and the possibility that relevant accounting principles will be amended, it is not possible for the Company to determine the probable financial effect that the final outcome of the CPUC reasonableness review will have on the Company's financial position and results of operations.

**Palo Verde Units 1, 2 and 3—
Proposed Rate Treatment—**

Palo Verde Unit 1 was placed into commercial operation on February 1, 1986 and Units 2 and 3 are scheduled for commercial operation in the third quarters of 1986 and 1987, respectively. On May 31, 1985, the Company filed a MAAC application with the CPUC for rate recovery of the Company's share of owning and operating Unit 1. In this filing the Company requested rate recovery on the basis of traditional ratemaking practices commencing when the unit achieved commercial operation.

The CPUC Public Staff on June 17, 1985 recommended the use of an unconventional ratemaking method for the Company's share of the output of the Palo Verde Units. This ratemaking method, which is known as "avoided-cost ratemaking," was designed for non-utility power plants. Under this method, the Company's share of the Palo Verde output would be priced based upon the cost of other generation sources, the use of which would be avoided through the operation of the Palo Verde Units. On December 18, 1985, the CPUC rejected the use of "avoided cost ratemaking" and directed the Company and its staff to investigate other ratemaking methods which fulfill the CPUC's objectives of ensuring cost effectiveness, providing operating performance incentives, and fairly allocating the plant's capital costs between current and future ratepayers.

However, on August 9, 1985, the CPUC authorized the Company to implement an interim balancing account procedure until the permanent ratemaking method for Palo Verde is determined.

In addition to considering alternative ratemaking methods, the CPUC is participating in a four state regulatory reasonableness review of the Palo Verde construction costs.

Fuel Supply Contract Settlements—

The Company has entered into an agreement with a major fuel oil supplier to settle litigation arising from the termination of a fuel supply contract. In accordance with the agreement, the Company has paid the supplier \$350 million and has entered into a ten-year option agreement for the purchase of low sulfur fuel oil. Under the terms of the option agreement, the Company is required to pay \$9 million annually for the supplier's commitment to deliver fuel oil on relatively short notice at current market prices.

The Company has also entered into uranium supply contract termination agreements to cancel contractual purchase obligations with two uranium suppliers. During 1985, the Company paid an \$18.2 million settlement amount relating to one of the suppliers and \$30.7 million as a partial settlement of a \$63.9 million termination obligation relating to the other uranium supplier.

These payments have been recorded in the Company's regulatory balancing accounts pending decisions by the CPUC and FERC regarding their recovery in rates.

The Company believes that the terms and conditions of these fuel supply settlement agreements are reasonable and in the best interest of the Company and its ratepayers. Although the Company cannot predict with certainty whether the CPUC and the FERC will allow the Company to recover its costs under or resulting from the option and settlement agreements, the Company believes that such costs are a proper item for rate recovery and does not expect that it will be denied recovery of amounts in future rate proceedings that will have a material adverse effect on the financial condition of the Company.

Resale Rates—

In accordance with FERC procedures, the Company's resale rate increases are subject to refund with interest to the extent that they are subsequently determined by the FERC to be inappropriate. As of December 31, 1985, revenues subject to refund, after giving effect to incremental fuel cost adjustment billing credits, aggregated approximately \$680.1 million. The Company believes that the amount of refunds, if any, likely to result from the outstanding proceedings would not have a material effect on the results of operations.

NOTE 3—Short-term Borrowings

In order to continue lines of credit with various banks, the Company presently maintains deposits aggregating approximately \$7,000,000 which are not legally restricted as to withdrawal. The lines of credit, which are also available to support commercial paper, amounted to \$572,000,000 and \$567,000,000 as of December 31, 1985 and 1984, respectively.

Short-term borrowings and related weighted-average interest rates were \$15,000,000 and 8.92% at December 31, 1985. At December 31, 1984, the Company did not have any outstanding short-term borrowings.

The Company has guaranteed commercial paper (included on the Company's balance sheet) issued by one of its wholly owned subsidiaries engaged in financings. Proceeds from the issuance of the commercial paper are used for capitalization of an affiliate engaged in Eurodebenture borrowings. The lines of credit available for the issuance of commercial paper amounted to \$96,400,000 and \$150,000,000 as of December 31, 1985 and 1984, respectively. Commercial paper issued in excess of the subsidiary's lines of credit is supported by the Company's lines of credit.

Short-term borrowings and related weighted-average interest rates of the Company's financing subsidiary were \$148,850,000 and 8.15% at December 31, 1985 and \$141,950,000 and 8.60% at December 31, 1984.

NOTE 4—Income Taxes

The current and deferred components of income tax expense are as follows:

	Year Ended December 31,		
	1985	1984	1983
Current:	(In Thousands)		
Federal	\$ (39,600)	\$ 140,510	\$ 178,246
State	24,841	56,760	58,655
	(14,759)	197,270	236,901
Deferred—Federal and State:			
Investment tax credits—net	84,134	55,323	69,416
Accelerated cost recovery system property	145,957	129,808	131,233
Regulatory balancing accounts	365,329	205,013	(3,919)
Fuel contract settlements	91,681	(15,104)	(21,586)
Other	36,668	37,899	(31,969)
	723,769	412,939	143,175
Total income tax expense	\$ 709,010	\$ 610,209	\$ 380,076
Income taxes included in operating expenses	\$ 720,938	\$ 639,875	\$ 497,236
Income taxes included in other income	(11,928)	(29,666)	(117,160)
Total income tax expense	\$ 709,010	\$ 610,209	\$ 380,076

Total income tax expense includes the current tax liability generated from the Company's operations and deferred income taxes provided on certain items of income and expense which are reported in different periods for tax and financial statement purposes. Consistent with current ratemaking procedures, the major items for which deferred income taxes are provided include the tax effects of regulatory balancing account provisions and accelerated depreciation under the provisions of the Accelerated Cost Recovery System.

Deferred income taxes for certain property-related timing differences have not been provided because the tax effects of such timing difference reversals are not allowed for retail ratemaking purposes until the taxes become payable. The cumulative net amounts of these timing differences were approximately \$2,014,000,000 and \$1,806,000,000 at December 31, 1985 and 1984, respectively. The tax effects of these timing differences are expected to be recovered in future rates. The cumulative net amount of timing differences not related to property is insignificant.

In accordance with the provisions of the Economic Recovery Tax Act of 1981, all investment tax credits generated after 1982 are being deferred and amortized as reductions to income tax expense ratably over the lives of the property giving rise to the credits.

The following table reflects the differences between state and Federal income taxes reported and the tax amount determined on income before taxes by applying the Federal statutory tax rate. The Federal and the composite Federal and state statutory income tax rates are 46% and 51.184%, respectively.

Year Ended December 31,	1985	1984	1983
	(In Thousands)		
Expected federal income tax expense at statutory rate	\$ 682,234	\$ 617,613	\$ 492,594
Increase (Decrease) in income tax expense resulting from:			
Allowance for equity and borrowed funds used during construction	(72,539)	(89,602)	(168,294)
Federal deduction for state taxes on income	(54,578)	(46,414)	(24,712)
Depreciation timing differences not deferred	92,900	77,841	45,732
State tax provision	118,647	100,900	53,723
All other differences	(57,654)	(50,129)	(18,967)
Total income tax expense	\$ 709,010	\$ 610,209	\$ 380,076
Pretax income	\$1,483,117	\$1,342,637	\$1,070,856
Effective tax rate (Total income tax expense ÷ Pretax income)	47.8%	45.4%	35.5%

NOTE 5—Employee Benefit Plans

Pension Plan—

The Company maintains a trustee, non-contributory pension plan, which covers substantially all employees. The annual normal cost of the plan is funded by the Company with contributions determined on the basis of a level premium funding method. Unfunded prior service costs relating to 1982 and 1985 plan amendments are being funded over 30-year periods. Pension costs are provided for on the basis of actuarial determinations and amounted to \$57,859,000, \$54,820,000 and \$48,701,000 for the years 1985, 1984 and 1983, respectively.

	At January 1,	1985 (a)	1984
	(In Thousands)		
Actuarial present value of accumulated plan benefits:			
Vested		\$608,240	\$586,003
Nonvested		49,460	49,143
		\$657,700	\$635,146
Net assets available for plan benefits		\$795,845	\$746,551

(a) Latest available data.

Actuarial rate of return assumptions used in determining the actuarial present value of accumulated plan benefits were 7.5% and 7.0% as of January 1, 1985 and 1984, respectively.

Employee Stock Plans—

The Company maintains an Employee Stock Ownership Plan (ESOP) and a Stock Savings Plus Plan (SSPP) to supplement its employees' retirement income. Contributions to the ESOP are funded primarily by Federal income tax benefits available to the Company and contributions made by participating employees. The Company's contributions to the SSPP amounted to \$13,878,000, \$12,539,000 and \$5,639,000 for the years 1985, 1984 and 1983, respectively.

Other Post-Retirement Benefits—

The Company provides certain health care and life insurance benefits for retired employees and their dependents. Group life insurance benefits are provided through an insurance company. Health care benefits are provided through a combination of Company health care facilities and health insurance programs. The cost of providing these benefits to retirees was \$13,100,000 and \$8,900,000 for the years 1985 and 1984, respectively.

NOTE 6—Jointly-Owned Utility Projects

The Company owns undivided interests in several jointly owned generating stations and transmission systems for which each participant must provide its own financing. The Company's proportionate share of expenses pertaining to

such projects is included in the appropriate category of operating expenses in the Statements of Income. The amounts in the table below represent the Company's investment in each such project as reported on the Balance Sheet as of December 31, 1985:

Projects	Utility Plant in Service	Accumulated Depreciation	Construction Work in Progress	Ownership Interest
	(In Thousands)			
El Dorado Transmission System	\$ 21,615	\$ 7,293	\$ 1	60.0%(a)
Four Corners Coal Generating Station ---Units 4 & 5	367,697	64,530	4,340	48.0
Mohave Coal Generating Station	208,630	71,828	6,737	56.0
Pacific Intertie DC Transmission System	110,127	27,141	3,538	50.0
Palo Verde Nuclear Generating Station	1,069	63	1,375,138	15.8
San Onofre Nuclear Generating Station:—				
Unit 1	395,308	99,751	42,800	80.0
Units 2 & 3	2,915,941	209,678	7,270	75.05
Common Facilities—Units 2 & 3	714,161	37,061	1,563	75.05
Common Facilities—Units 1,2&3	117,938	12,249	30,284	75.87
Solar One Generating Station	18,073	12,391	—	80.0
Yuma Axis Combined Cycle Generating Station	12,369	8,964	—	33.3
Total	\$4,882,928	\$550,949	\$1,471,671	

(a) Represents a composite rate.

NOTE 7—Leases

Rental payments charged to operating expenses amounted to \$124,153,000, \$127,022,000 and \$61,714,000, for the years 1985, 1984 and 1983, respectively.

The Company leases nuclear fuel to meet a portion of its energy requirements. Under the terms of the lease agreement, quarterly payments are based upon consumption of the nuclear fuel and are designed to return the accumulated investment in nuclear fuel and a financing charge on unrecovered costs to the lessor. Such payments are recoverable through the Company's ECAC procedures.

The nuclear fuel lease, and certain other leased property, meet the criteria requiring capitalization under generally accepted accounting principles for unregulated enterprises. Had such leases been capitalized, the Company's Balance Sheets would have included additional assets and liabilities of approximately \$556,000,000 and \$557,000,000 at December 31, 1985 and 1984, respectively. In accordance with an accounting standard applicable to rate regulated enterprises, the Company is required to record the assets and obligations of such leases on its Balance Sheet commencing in 1987.

At December 31, 1985, estimated rental commitments for unrecorded capital leases and noncancelable operating leases consisted of the following:

Year Ended December 31,	Capital Leases (a)	Operating Leases
	(In Thousands)	
1986	\$ 3,157	\$17,597
1987	1,199	15,224
1988	583	13,050
1989	396	10,809
1990	35	8,482
For Periods Thereafter	—	19,143
Total Future Rental Commitments	5,370	\$84,305
Less amount representing interest	645	
Present value of future minimum rental commitments	\$ 4,725	

(a) Excludes nuclear fuel, the cost base of which is payable when the fuel is consumed. The unrecovered cost base of the nuclear fuel lease was approximately \$551,000,000 at December 31, 1985.

NOTE 8—Commitments

Construction Program and Fuel Supply—

The Company has significant purchase commitments in connection with its continuing construction program. As of December 19, 1985 (the date of the Company's latest approved budget), funds required for construction expenditures are estimated at \$1,093,000,000 for 1986, \$822,000,000 for 1987 and \$751,000,000 for 1988. Minimum long-term commitments of approximately \$1,736,000,000, which include the amounts required by the contract settlements with major fuel suppliers discussed in Note 2, existed on December 31, 1985 under the Company's fuel supply and transportation arrangements.

Nuclear Waste Policy Act—

Pursuant to the Nuclear Waste Policy Act of 1982, contracts have been entered into with the U.S. Department of Energy (DOE) for disposal of spent nuclear fuel. Under contract terms, the Company is required to pay a quarterly fee of one mill per kilowatt hour to the DOE for nuclear generation on and after April 7, 1983. For generation prior to April 7, 1983, payment of a one-time fee equivalent to one mill per kilowatt hour plus accrued interest is required. This one-time fee has been recorded as a deferred charge pending future rate recovery, and including accrued interest, approximated \$27,902,000 at December 31, 1985. The Company has elected to pay for this one-time fee by making equal payments over forty quarters. Such payments commenced during the third quarter of 1985. The amounts charged to income for current generation were \$8,925,000, \$7,707,000 and \$2,185,000 for the years ended December 31, 1985, 1984 and 1983, respectively. Recovery of the expenses associated with disposal of spent nuclear fuel through the Company's ECAC procedures commenced January 1, 1984.

Long-term Purchased Power and Transmission Contracts—

Under firm contracts, the Company has agreed to purchase portions of the generating output of certain facilities and to purchase firm transmission service where appropriate. Although the Company has no investment in such facilities, these contracts provide that the Company pay certain minimum amounts (which are based at least in part on the debt service requirements of the provider) whether or not the facility or transmission line is operating. None of these power contracts provides, or is expected to provide, in excess of 5 percent of the Company's current or estimated future operating capacity. The cost of power and firm transmission service obtained under these contracts, including payments made when a facility or transmission line is not operating, is included in Purchased Power and Other Operating Expenses, respectively, in the Statements of Income. Purchased power costs are generally recoverable through the Company's ECAC procedure. Selected information as of December 31, 1985 pertaining to purchased power contracts is summarized in the following table:

Share of Effective Operating Capacity—Megawatts (a)	727
Share of Energy Output (b)	7.9%–100%
Total Estimated Annual Cost	\$111,610,000
Company's Portion of Estimated Annual Cost	
Applicable to Suppliers' Annual Minimum Debt Service Requirement	\$ 18,825,000
Company's Allocable Portion of Interest of Suppliers Included in Annual Minimum Debt Service	\$ 12,974,000
Related Long-Term Debt or Lease Obligations Outstanding	None

(a) Effective operating capacity may vary according to water availability and other conditions.

(b) According to the provisions of a certain contract, the Company's share of energy output from the contracted facility varies at different times.

Additional information as of December 31, 1985 pertaining to both purchased power and transmission service contracts is summarized in the following table:

	Purchased Power	Transmission Service
Dates of Expiration	1987–1990	1990–2016
Variable Components of Contracts	(a)	(a)
Required Future Minimum Annual Payments	(In Thousands)	
1986	\$ 68,954	\$ 11,502
1987	66,316	11,380
1988	63,667	11,201
1989	45,966	9,446
1990	14,209	6,063
Later years	—	101,618
Total	259,112	151,210
Less Amount Representing Interest to Reduce Total to Present Value	(60,877)	(79,646)
Total at Present Value	<u>\$198,235</u>	<u>\$ 71,564</u>
Total Purchases for the Years Ended December 31,		
1985	\$91,421	\$10,090
1984	32,023	7,970
1983	7,204	6,397

(a) The variable components of certain contracts are based upon a pro-rata share of actual operating, maintenance, and fuel costs or on the U.S. Government cost of service.

NOTE 9—Contingencies

Nuclear Insurance—

The Price-Anderson Act currently limits the public liability claims that could arise from a nuclear incident to a maximum amount of \$650,000,000 for each licensed nuclear facility. Private insurance for this exposure has been purchased by the participants in the San Onofre and Palo Verde Nuclear Generating Stations, including the Company, in the maximum available amount, presently \$160,000,000 with the balance to be provided by secondary financial protection required by the Nuclear Regulatory Commission (NRC). Under the agreement with the NRC, the Company could be assessed retrospective premium adjustments, of up to \$26,170,000 per year, in the event of nuclear incidents involving any licensed reactor in the United States.

Property damage coverage is provided for losses up to \$500,000,000 at the San Onofre and Palo Verde Nuclear Generating Stations. Decontamination liability and property damage insurance in excess of the primary \$500,000,000 layer has also been purchased. Insurance to cover a portion of the additional expense of replacement power resulting from an accident-related outage of a nuclear unit is also provided. A maximum weekly indemnity in the amount of \$3,000,000 for a single unit for 52 weeks commences after the first 26 weeks of such an outage. An additional \$1,500,000 per week is provided for the next 52 weeks. These policies are primarily provided through mutual insurance companies owned by utilities with nuclear facilities. If losses at any nuclear facility covered by the arrangement were to exceed the accumulated funds available for these insurance programs, the Company could be assessed retrospective premium adjustments of up to \$66,486,000 per year. Insurance premiums paid by the Company are charged to Operating Expenses.

Government Licenses—

The terms and provisions of licenses granted by the United States cover the Company's major and certain minor hydroelectric plants, with a total effective operating capacity of 937.0 megawatts. These licenses also cover certain storage and regulating reservoirs and related transmission facilities. The above licenses expire at various times between 1986 and 2009. The licenses contain numerous restrictions and obligations on the part of the Company, including the right of the United States to acquire Company properties or, under certain conditions, the FERC to issue a license to a new licensee upon the payment to the Company of specified compensation. Applications of the Company for the relicensing of certain hydroelectric plants referred to above with aggregate effective operating capacity of 31.8 megawatts are pending. Any new licenses to the Company are expected to be issued upon terms and conditions less favorable than those of the expired licenses.

Antitrust Litigation—

In March 1978, five resale customers filed a suit against the Company in federal court alleging violation of certain antitrust laws. The complaint seeks monetary damages, a trebling of such damages and certain injunctive relief. The complaint alleges that the Company (i) is engaging in anti-competitive behavior by charging more for wholesale electricity sold to the resale customers than the Company

charges certain classes of its retail customers ("price squeeze"), and (ii) has taken action alone and in concert with other utilities to prevent or limit such resale customers from obtaining bulk power supplies from other sources to reduce or replace the resale customers' wholesale purchases from the Company ("foreclosure"). The plaintiffs have estimated their actual damages for alleged price squeeze, before trebling, at approximately \$22,780,000 and foreclosure damages stemming from alleged loss of energy and capacity at approximately \$82,500,000 before trebling, for the period February 1, 1978 to December 31, 1985. On January 10, 1986, the judge set a June 3, 1986 trial date. The foregoing proceedings involve complex issues of law and fact and, although unable to predict their final outcome, the Company has categorically denied the resale customers' allegations.

NOTE 10—Quarterly Financial Data

The following table presents financial data for each of the quarterly periods in the years 1985, 1984 and 1983:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1985				
Operating Revenues (000)	\$1,216,783	\$1,227,877	\$1,451,669	\$1,272,519
Operating Income (000)	250,721	244,193	264,262	213,578
Net Income (000)	201,518	189,702	209,979	172,909
Earnings Available for Common and Original Preferred Stock (000)	183,397	171,737	192,089	155,186
Earnings Per Share . . . . .	.86	.80	.89	.71
1984				
Operating Revenues (000)	\$1,084,158	\$1,135,079	\$1,410,506	\$1,269,408
Operating Income (000)	220,132	249,111	274,717	222,664
Net Income (000)	189,611	178,560	197,253	167,003
Earnings Available for Common and Original Preferred Stock (000)	171,309	160,266	178,968	148,841
Earnings Per Share . . . . .	.84	.78	.86	.70
1983				
Operating Revenues (000)	\$1,040,773	\$1,045,247	\$1,248,670	\$1,129,566
Operating Income (000)	161,636	161,440	171,271	209,683
Net Income (000)	168,948	172,576	192,077	157,179
Earnings Available for Common and Original Preferred Stock (000)	150,538	154,176	173,735	138,854
Earnings Per Share . . . . .	.77	.78	.87	.69

Management's Discussion and Analysis of Results of Operations and Financial Condition

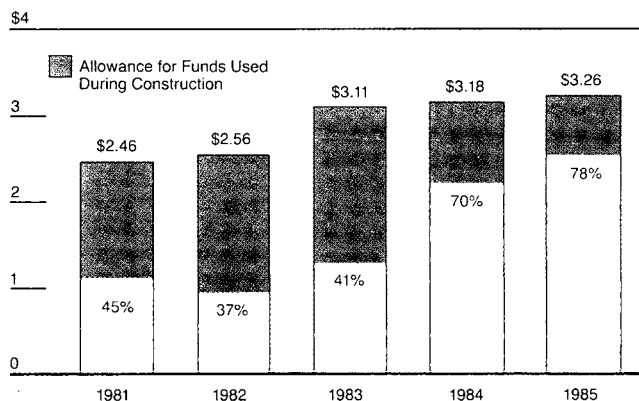
RESULTS OF OPERATIONS

Earnings Summary

The Company achieved record earnings for the fifth consecutive year. Earnings per share in 1985 were \$3.26, as compared to \$3.18 in 1984, reflecting a 2.5% increase.

As reflected in the following chart, the percentage of earnings exclusive of non-cash Allowances for Funds Used During Construction (AFUDC) has increased from 45% in 1981 to 78% in 1985, the highest level in ten years. Improvement in earnings quality is expected to continue in 1986 and 1987 as construction costs of Palo Verde Units 1, 2 and 3 are included in rates.

Quality of Earnings (Per Share)



The Company earned a 15.75% rate of return on common equity for 1985, slightly less than the California Public Utilities Commission (CPUC) authorized rate of 16%. This marks the fifth consecutive year that the Company's rate of return on common equity has been essentially in line with that authorized by the CPUC.

Operating Revenues and Sales

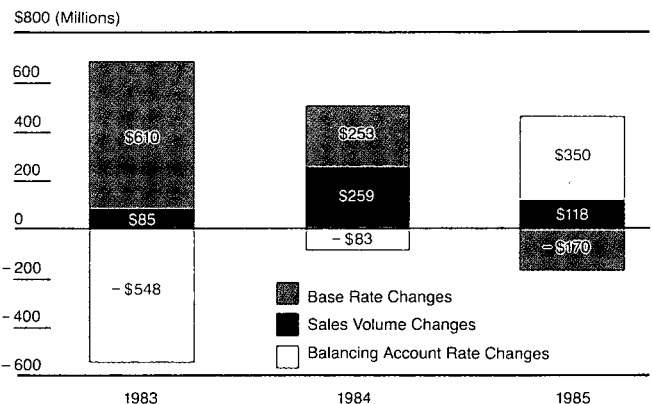
Operating revenues increased over the prior year by \$270 million or 5.5% in 1985, \$435 million or 9.7% in 1984, and \$162 million or 3.8% in 1983. This reflected, in addition to the net effect of changes in rates, increases in kilowatt-hour sales of 2.6%, 5.7% and 1.0% for the years 1985, 1984 and 1983, respectively.

Changes in rates during the three years included increases in base rates largely from CPUC general rate increases and attrition allowances, the establishment of rates to recover the investment-related costs of San Onofre Units 2 and 3, and decreases in rates providing recovery of energy costs.

The net effect of changes in rates was to increase the overall revenue per kilowatt-hour by 3.4% in 1985, 3.8% in 1984 and 2.5% in 1983.

The chart below reflects the changes in the major components of operating revenues which contributed to the overall increase for the past three years:

Operating Revenues - Changes



Effective January 1, 1986, the CPUC authorized an attrition allowance, increasing revenue by \$146.3 million to reflect changes in inflation and capital costs since the Company's last general rate case. This increase is subject to refund pending review by the CPUC of the Company's authorized return on common equity in 1986. A more complete description of the procedures used to establish the Company's rate levels for retail sales is discussed in Note 1 of the "Notes to Financial Statements."

Operating Expenses

The effect on earnings of fluctuations in the Company's fuel and purchased power expenses has been minimized by regulatory adjustment clauses established by the CPUC and the Federal Energy Regulatory Commission.

Increases in other operating expenses continue to be influenced by system growth and the operation of San Onofre Units 2 and 3, which were placed in service in August 1983 and April 1984, respectively. Further increases in other operating expenses are anticipated as Units 1, 2 and 3 at the Palo Verde Nuclear Generating Station commence commercial operation. Palo Verde Unit 1 began operating commercially on February 1, 1986. Units 2 and 3 are

scheduled for commercial operation in the third quarters of 1986 and 1987, respectively. Initial ratemaking treatment of operating expenses relating to the Palo Verde units is provided through an interim regulatory balancing account procedure established by the CPUC.

Maintenance expenses have been affected by the scheduling of major maintenance projects. Specifically, the level of maintenance expenses incurred during 1985 decreased by \$66.8 million, or 15.9% in comparison to 1984. Maintenance expenses were greater during 1984 due to the performance of previously deferred projects. As a result, 1984 reflects higher than normal maintenance expenses. Additional factors contributing to the variation in maintenance expense include the addition of new facilities, inflation and weather conditions.

Increases in depreciation expense are primarily due to the commercial operation of San Onofre Units 2 and 3. This trend is expected to continue during 1986 and 1987 as Palo Verde Units 1, 2 and 3 are placed into commercial operation.

Non-operating Items

Utilities are permitted to capitalize the cost of debt and equity funds used to finance the construction of utility plant. This is accomplished through non-cash Allowances for Funds Used During Construction.

The decline in AFUDC and accompanying non-operating income taxes during 1985 resulted primarily from the inclusion in rate base of San Onofre Unit 3 during the second quarter of 1984.

Interest income increased during 1985 by \$16.3 million, or 24.1% in comparison to 1984. This increase is primarily due to interest accrued on increased undercollections occurring in the Major Additions Adjustment Clause (MAAC) balancing account.

The before-tax interest coverage for 1985 was 4.4 times, the highest level achieved in 20 years. The continuing upward trend of interest coverage reflects increasing income and decreasing interest expense. The reduction in interest expense is due to the refinancing of debt at lower interest rates and reductions in interest expense associated with regulatory balancing accounts.

Supplementary information concerning the effects of changing prices is on Page 48.

FINANCIAL CONDITION

Internal Generation of Funds

During the past two years, the Company has obtained the majority of its required working capital from operations.

The Company's internal generation of funds reached 68% of its capital requirements in 1985, the highest level in over 25 years. The higher level of funds generated reflects the inclusion of San Onofre Units 2 and 3 in rate base.

Net regulatory balancing account undercollections increased by \$774 million during 1985. This increase is substantially due to the inclusion of settlement payments associated with the termination of fuel supply contracts in the Company's Energy Cost Adjustment Clause balancing account and an increase in the MAAC balancing account. The Company has submitted applications with the CPUC requesting expedited recovery of fuel contract settlement payments.

Capital Requirements

The following table shows the Company's projected capital requirements for the years 1986 through 1990:

	1986	1987	1988	1989	1990
	(in Millions)				
Construction Expenditures	\$1,093	\$822	\$751	\$796	\$ 801
Maturities of Long-Term Debt . . .	45	153	80	143	355
Redemptions of Preferred and Preference Stock	18	19	22	24	12
Capital Requirements	<u>\$1,156</u>	<u>\$994</u>	<u>\$853</u>	<u>\$963</u>	<u>\$1,168</u>

The Company's construction expenditures remain at a relatively high level due to major transmission and hydroelectric projects and the completion of the Palo Verde Nuclear Generating Station.

Rate Matters

The Company is currently involved in several pending regulatory issues which, if resolved unfavorably, could have a material adverse impact on the Company's financial condition and results of operations. At this time, it is not possible for the Company to determine the final outcome of these issues, which are more fully discussed in Note 2 of "Notes to Financial Statements." These rate matters include:

- The rate treatment for the portion of San Onofre Units 2 and 3 revenues which have been recorded in the MAAC balancing account and included in reported earnings but not collected from customers.
- The review by the CPUC of the reasonableness of the construction costs for San Onofre Units 2 and 3 and the Palo Verde units.
- The potential amendments to utility accounting principles regarding, among other matters, the manner in which regulatory cost disallowances are reflected in reported earnings.
- The ultimate rate treatment to be accorded the Company's investment in the Palo Verde Nuclear Generating Station.

Capital Sources

The Company's estimates of funds available from future operations assume the receipt of adequate and timely rate relief, the timely inclusion of the Palo Verde units in rate base and the realization of its assumptions regarding cost fluctuations, including the cost of capital. The Company's estimates and underlying assumptions are subject to continuous review and periodic revision.

The timing, type and amount of all additional long-term financing is influenced by market conditions, rate relief and other factors, including limitations imposed by the Company's Articles of Incorporation and Trust Indenture.

Capital Structure

The Company's long-term goal is to maintain a capital structure with approximately equal amounts of debt and equity. The Company's capital structure as of December 31, 1985 is shown in the table below:

Common Equity	45.1%
Preferred and Preference Stock	8.5
Long-Term Debt	<u>46.4</u>
Total	<u>100.0%</u>

In 1985, the Company completed \$1.1 billion of long-term financing, its most ambitious long-term financing program completed in a single year. Of this amount, approximately \$764 million was used to replace maturing bonds and to refinance high cost debt with lower interest rate bonds. The Company uses short-term borrowings and temporary investments as a part of normal daily operations. A total of \$572 million is available for short-term borrowings from foreign and domestic banks.

Operating Revenues and Kilowatt-Hour Sales

Class of Service	Operating Revenues				Kilowatt-Hour Sales (000)			
	% of 1985 total	(In Thousands)		% change	% of 1985 total	1985	1984	% change
		1985	1984					
Residential	28.0	\$1,449,424	\$1,378,850	5.1	28.6	18,582,806	18,289,564	1.6
Agricultural	1.6	84,282	81,841	3.0	1.6	1,014,564	1,027,717	(1.3)
Commercial	31.5	1,625,179	1,501,399	8.2	29.4	19,110,474	18,354,975	4.1
Industrial	23.4	1,207,470	1,183,162	2.1	24.2	15,707,038	15,858,234	(1.0)
Public Authorities	8.3	427,704	402,087	6.4	7.5	4,885,200	4,738,924	3.1
Interdepartmental	—	98	116	(15.5)	—	1,106	1,110	(0.4)
Resale	6.7	347,578	295,504	17.6	8.7	5,683,378	5,039,523	12.8
Sales of Electric Energy	99.5	5,141,735	4,842,959	6.2	100.0	64,984,566	63,310,047	2.6
Other Electric Revenues .	0.5	27,113	56,193	(51.8)	—	—	—	—
Total	100.0	\$5,168,848	\$4,899,152	5.5	100.0	64,984,566	63,310,047	2.6

Operating Revenues by Rate Components

Rate Components	Operating Revenues			Percent of Total		
	(In Thousands)			1985	1984	1983
	1985	1984	1983			
Base Rates—CPUC Jurisdiction	\$2,411,836	\$2,382,081	\$2,138,011	46.7	48.6	47.9
Energy Cost Adjustment Billing Factor	1,587,763	1,413,433	1,789,474	30.7	28.9	40.1
Annual Energy Rate	115,027	211,103	163,817	2.2	4.3	3.7
Major Additions Adjustment Billing Factor	732,232	395,545	29,651	14.2	8.1	0.7
Other Billing Factors	(52,617)	145,522	33,189	(1.0)	3.0	0.7
Resale Rates (excluding fringe)	347,494	295,275	259,477	6.7	6.0	5.8
Sales of Electric Energy	5,141,735	4,842,959	4,413,619	99.5	98.9	98.9
Other Electric Revenues	27,113	56,193	50,637	0.5	1.1	1.1
Total	\$5,168,848	\$4,899,152	\$4,464,256	100.0	100.0	100.0

Supplementary Information to Disclose the Effects of Changing Prices (Unaudited)

The Company's primary financial statements are stated on the basis of historical costs in accordance with generally accepted accounting principles. As a result of price level changes occurring in current and prior accounting periods, amounts reported on this basis reflect dollars of varying purchasing power and accordingly do not measure the effects of inflation. The following supplementary information is presented for the purpose of providing certain information about the effects of changing prices on reported financial data.

This information inherently involves the use of assumptions, approximations and estimates, and therefore, should be viewed in that context and not as precise measurements of the effects of inflation on the Company.

Current cost amounts reflect the changes in specific prices of utility plant from the date the plant was acquired to the present. The current cost of utility plant represents the estimated cost of replacing existing plant assets and was determined by restating its historical cost using indices reported in the Handy-Whitman Index of Public Utility Construction Costs.

For purposes of determining Earnings Available for Common and Original Preferred Stock at current cost, total operating revenues and all expenses other than depreciation were considered to reflect the average price level for the current year and accordingly remain unchanged from those amounts reported in the Company's primary financial statements. Depreciation expense on the current cost amounts of utility plant was determined by applying the Company's average annual depreciation rates to the indexed plant amounts. This method is intended to measure income after reflecting the cost of providing electric service at current price levels.

Under ratemaking procedures prescribed by the regulatory commissions exercising rate jurisdiction over the Company, only the historical cost of utility plant is recoverable in revenues as depreciation expense. Therefore, the cost of utility plant stated in terms of current cost that varies from the historical cost of plant is not considered in establishing rates charged to customers. The amount of this variance is reflected as an adjustment of utility plant to net recoverable cost. While the ratemaking process gives no recognition to the current cost of replacing utility plant, based on past ratemaking practices, the Company believes it will be allowed to recover and earn a return on the increased cost of its investment when replacements of utility plant occur.

Selected financial data stated in constant dollars are adjusted to reflect the effects of general inflation. Such amounts represent historical costs restated in terms of dollars of equal purchasing power as measured by the Consumer Price Index for all urban consumers.

Statement of Earnings Available for Common and Original Preferred Stock Adjusted for Changing Prices for the Year Ended December 31, 1985 (Unaudited)

	As Reported (Primary Financial Statements)	Adjusted (Changes in Specific Prices (a)— Current Cost)
	(In Thousands)	
Total Operating Revenues	\$5,168,848	\$5,168,848
Operating Expenses:		
Depreciation	454,574	933,000
Other operating expenses	3,741,520	3,741,520
Total Other Income	(254,638)	(254,638)
Net Interest Charges	453,285	453,285
Dividends on Cumulative Preferred and Preference Stock	71,698	71,698
	<u>4,466,439</u>	<u>4,944,865</u>
Earnings available for Common and Original Preferred Stock (b)	<u>\$ 702,409</u>	<u>\$ 223,983</u>
Other Adjustments For Changing Prices:		
Increase in specific prices at current cost of utility plant held during the year (c)		\$ 599,804
Adjustment of utility plant to net recoverable cost		190,226
Effect of increase in general price level on utility plant		<u>(697,622)</u>
Excess of increase in specific prices over increase in general price level, after adjustment to net recoverable cost		<u>\$ 92,408</u>
Gain from decline in purchasing power of net amounts owed		<u>\$ 223,248</u>

(a) In average 1985 dollars.

(b) Excludes adjustment of Utility Plant to Net Recoverable Cost.

(c) At December 31, 1985, current cost of utility plant, net of accumulated depreciation (but exclusive of deferred income taxes) was \$19,302,456,000 while related historical cost and net recoverable cost was \$10,838,219,000.

**Five Year Comparison of Selected Supplementary Financial Data
Adjusted for the Effects of Changing Prices (Unaudited)**

In Thousands, Except Per Share Amounts

(Data adjusted for the effects of changing prices are reported in average 1985 dollars.)

	Year Ended December 31,	1985	1984	1983	1982	1981
Total Operating Revenues						
—As reported		\$5,168,848	\$4,899,152	\$4,464,256	\$4,302,602	\$4,054,356
—In constant 1985 dollars		\$5,168,848	\$5,073,953	\$4,820,319	\$4,795,221	\$4,795,571
Earnings Available for Common and Original Preferred Stock (a)						
—As reported		\$702,409	\$659,385	\$617,303	\$483,358	\$422,024
—At current cost		\$223,983	\$186,431	\$143,245	\$109,096	\$ 85,407
Earnings Per Share on Common and Original Preferred Stock (a)						
—As reported		\$3.26	\$3.18	\$3.11	\$2.56	\$2.46
—At current cost		\$1.04	\$.90	\$.72	\$.58	\$.50
Excess of Increase in Specific Prices Over Increase in General Price Level of Utility Plant after Adjustment to Net Recoverable Cost		\$ 92,408	\$105,664	\$161,577	\$ 50,464	\$(311,603)
Net Assets at Net Recoverable Cost						
—As reported		\$4,575,400	\$4,242,788	\$3,793,339	\$3,392,864	\$2,968,108
—At current cost		\$4,502,730	\$4,332,888	\$4,027,064	\$3,713,250	\$3,390,018
Gain from Decline in Purchasing Power of Net Amounts Owed		\$223,248	\$231,155	\$217,715	\$228,938	\$443,095
Dividends Declared Per Common Share						
—As reported		\$2.13	\$2.01	\$1.83	\$1.69	\$1.55
—In constant 1985 dollars		\$2.13	\$2.07	\$1.97	\$1.87	\$1.82
Market Price Per Share at Year End						
—In historical dollars		\$26.63	\$22.75	\$19.88	\$17.56	\$14.38
—In constant 1985 dollars		\$26.21	\$23.23	\$21.10	\$19.35	\$16.42
Average Consumer Price Index (Base Year 1967 = 100)		322.2	311.1	298.4	289.1	272.4

(a) Excludes adjustment of Utility Plant to Net Recoverable Cost.

Capital Stock—Dividend and Price Information

Class and Series of Stock	Quarterly Dividends Paid Per Share (a)(f)	High and Low Sales Prices (\$)															
		Calendar Quarter—1985								Calendar Quarter—1984							
		First		Second		Third		Fourth		First		Second		Third		Fourth	
		High	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low
Common (b)(c) Original	\$.51	24¾	22⅞	27⅞	23⅞	27⅞	22¾	28½	22¾	20¼	17⅞	19½	17¼	22⅞	18⅞	24⅞	20⅞
Preferred Cumulative Preferred:	1.02	44	41¼	51½	42¾	51	45¾	52	44	38½	33	35½	33	40	33¾	42	38½
4.08%	.25½	9⅞	8½	10¾	8⅞	10⅞	9½	11	9¾	9⅞	8	8½	7⅞	9⅞	7⅞	8⅞	8⅞
4.24%	.26½	10	8¾	10⅞	9⅞	11⅞	9¾	11¾	10	9½	8½	8¾	7¾	8⅞	7⅞	9⅞	8⅞
4.32%	.27	10⅞	8¾	11	9¼	11⅞	9⅞	11⅞	9¾	9⅞	8¼	9	7¾	9	8	9⅞	8⅞
4.78%	.29⅞	11⅞	10	12	10⅞	12¾	10⅞	12¼	10⅞	10¾	9⅞	10⅞	8½	10	8½	10¼	8⅞
5.80%	.36¼	13¾	11⅞	14¾	12½	14¾	11⅞	15⅞	13¾	12¾	11¼	11⅞	10½	12	10⅞	12⅞	11⅞
8.85%	.553125	20¾	17¾	23⅞	19	22¼	20⅞	24	20⅞	19	17¼	17¼	16	19	16⅞	19⅞	17⅞
9.20%	.57½	21¼	18¾	22⅞	19⅞	23½	20⅞	24	21¼	20	18¼	18⅞	16¾	18⅞	17	20	17¼
\$100 Cumulative Preferred:																	
7.325% (d)	1.83⅞	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
7.58%	1.89½	68	60	75⅞	63½	72½	69⅞	79	69	62¾	57	60	56	60¼	53½	64	55¼
7.80% (d)	1.95	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
8.54%	2.13½	82½	75¾	90½	86¼	92¼	89½	96	90½	77¾	70	76¾	72	75½	69	76¾	69¼
8.70%	2.17½	75	68⅞	85⅞	72	85½	79	93	78	72½	68	70	61⅞	70	62½	72¼	61
8.70%-A (d)	2.17½	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
8.96%	2.24	78¼	71⅞	88	75	86¾	80½	92	80½	77	68¾	74	64½	73	65	74½	70
12.00%	3.00	110	102½	109¾	106½	110⅞	108⅞	109⅞	109¼	105⅞	100	102¾	95⅞	104	94½	104½	99¾
12.31% (d)	3.0775	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Preference:																	
5.20% (e)	.32½	38½	35¼	43½	38¼	43⅞	38	44¼	37⅞	30⅞	28	29⅞	27¼	34⅞	28⅞	37⅞	33⅞
7.375% (d)	.460938	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—

- (a) Quarterly dividends were paid at the rates indicated in each quarter of 1985 except the third and fourth quarter dividends on Original Preferred Stock and Common Stock which were at the rate of \$1.08 and \$0.54 per share, respectively.
- (b) Dividends declared per share on Common Stock totaled \$2.13 and \$2.01 for 1985 and 1984, respectively.
- (c) As of December 31, 1985, there were approximately 163,000 Common Stock shareholders.
- (d) There are no prices as these issues are private placements and shares are not traded.
- (e) The 5.20% Series Preference Stock is convertible into Common Stock.
- (f) The Indenture securing the Company's First and Refunding Mortgage Bonds provides, in substance, that the Company shall not pay any cash dividends except out of its earnings reinvested in the business and net income.

Selected Financial Data 1975–1985

		1985	1984
Summary of Operations	Operating Revenues	\$ 5,168,848	\$ 4,899,152
<i>(in thousands,</i>	Operating Expenses	4,196,094	3,932,527
<i>except percent and</i>	Fuel and Purchased Power Costs (a)	2,389,087	2,084,941
<i>per share data)</i>	Income Taxes (a)	720,938	639,875
	Allowance for Borrowed and Equity Funds Used During		
	Construction	157,694	194,787
	Total Interest Charges	487,800	530,322
	Net Income	774,107	732,428
	Earnings Available for Common and Original		
	Preferred Stock	\$ 702,409	\$ 659,385
	Weighted Average Shares of Common and Original Preferred		
	Stock Outstanding (000)	215,649	207,576
	Per Share Data:		
	Earnings Per Common Share	\$3.26	\$3.18
	Dividends Declared Per Common Share	\$2.13	\$2.01
	Dividend Payout Ratio (paid basis)	64.4%	61.9%
	Rate of Return on Common Equity	15.75%	16.3%
	Ratio of Earnings to Fixed Charges	3.80	3.38
Balance Sheet Data	Total Assets (b)	\$12,593,449	\$11,358,730
<i>(in thousands,</i>	Gross Utility Plant	13,990,360	12,835,031
<i>except percent and</i>	Accumulated Depreciation	3,152,141	2,763,651
<i>per share data)</i>	Percent of Gross Utility Plant	22.5%	21.5%
	Common Stock, at par value	\$ 902,821	\$ 885,637
	Additional Paid-In Capital	1,543,933	1,470,347
	Earnings Reinvested in the Business	2,128,646	1,886,804
	Common Shareholders' Equity	4,575,400	4,242,788
	Preferred and Preference Stock		
	—without mandatory redemption requirements	466,500	467,258
	—with mandatory redemption requirements (c)	395,074	422,286
	Long-Term Debt (c)	\$ 4,717,411	\$ 4,248,647
	Capital Structure (percent):		
	Common Shareholders' Equity	45.1%	45.2%
	Preferred and Preference Stock		
	—without mandatory redemption requirements	4.6	5.0
	—with mandatory redemption requirements (c)	3.9	4.5
	Long-Term Debt (c)	46.4%	45.3%
	Book Value Per Common Share	\$21.04	\$19.89
Operating and Sales Data	Area Peak Demand (MW)	14,587	15,189
	Area Generating Capacity at Peak (MW)	17,776	17,354
	Total Energy Requirement (KWH)(000)	73,751,683	72,431,689
	Percent Energy Requirement:		
	Thermal	58.7%	54.0%
	Renewable/Alternative (including hydro)	6.0	7.6
	Purchased Power and Other Sources (d)	35.3%	38.4%
	Kilowatt-Hour Sales (000)	64,984,566	63,310,047
	Average Annual KWH Sales Per Residential Customer	6,099	6,147
	Number of Customers	3,490,325	3,400,182
	Number of Employees	17,182	16,844

(a) Included in Operating Expenses.

(b) The years 1975 through 1981 have been restated to reflect the deduction of property-related accumulated deferred income taxes from Utility Plant.

(c) Excludes current portion.

1983	1982	1981	1980	1979	1978	1977	1976	1975
\$ 4,464,256	\$ 4,302,602	\$ 4,054,356	\$ 3,661,117	\$ 2,563,974	\$ 2,328,798	\$ 2,064,914	\$ 1,846,540	\$ 1,647,134
3,760,225	3,765,875	3,563,201	3,288,983	2,178,978	2,004,197	1,734,192	1,539,400	1,380,528
2,027,756	2,227,901	2,558,206	2,010,227	1,532,903	1,204,749	1,189,597	903,447	824,826
497,236	177,251	197,865	38,683	100,292	72,803	68,792	59,506	46,623
365,856	303,118	232,552	162,287	118,566	78,421	60,238	47,610	26,773
539,377	420,282	340,977	282,656	205,082	182,658	161,078	144,368	126,185
690,780	555,754	489,912	317,536	346,219	251,683	251,979	226,798	176,781
\$ 617,303	\$ 483,358	\$ 422,024	\$ 256,586	\$ 292,481	\$ 202,226	\$ 206,330	\$ 185,047	\$ 137,177
198,348	188,514	171,220	146,482	128,404	114,954	108,694	97,356	95,930
\$3.11	\$2.56	\$2.46	\$1.75	\$2.28	\$1.76	\$1.90	\$1.90	\$1.43
\$1.83	\$1.69	\$1.55	\$1.42	\$1.30	\$1.15	\$1.03	\$.84	\$.84
57.7%	64.5%	61.5%	79.4%	55.7%	63.6%	50.5%	44.2%	58.7%
17.0%	14.9%	14.9%	10.4%	13.6%	10.7%	12.0%	12.4%	9.8%
2.91	2.44	2.72	2.09	2.90	2.53	2.78	2.83	2.63
\$11,035,060	\$10,157,564	\$8,699,721	\$7,706,933	\$6,949,917	\$6,030,045	\$5,698,068	\$4,993,330	\$4,701,910
11,886,610	10,764,078	9,517,670	8,406,309	7,577,670	6,810,891	6,191,733	5,658,433	5,147,333
2,426,368	2,185,667	2,015,212	1,840,233	1,676,148	1,519,174	1,383,009	1,258,327	1,149,311
20.4%	20.3%	21.2%	21.9%	22.1%	22.3%	22.3%	22.2%	22.3%
\$ 839,501	\$ 805,766	\$ 730,027	\$ 632,115	\$ 540,791	\$ 521,138	\$ 455,387	\$ 442,739	\$ 395,707
1,307,413	1,193,318	999,764	805,325	638,046	595,701	458,096	427,424	350,505
1,646,425	1,393,780	1,238,317	1,092,137	1,054,296	931,217	862,956	769,425	671,548
3,793,339	3,392,864	2,968,108	2,529,577	2,233,133	2,048,056	1,776,439	1,639,588	1,417,760
469,025	471,020	476,308	482,652	489,822	503,650	518,172	537,753	537,753
440,500	445,000	399,500	399,500	324,500	197,000	197,000	75,000	75,000
\$ 4,051,836	\$ 3,970,400	\$ 3,444,080	\$ 2,945,824	\$ 2,746,207	\$ 2,477,474	\$ 2,314,874	\$ 2,151,861	\$ 2,033,038
43.3%	41.0%	40.7%	39.8%	38.5%	39.2%	37.0%	37.2%	34.9%
5.4	5.7	6.5	7.6	8.5	9.6	10.8	12.2	13.2
5.0	5.4	5.5	6.3	5.6	3.8	4.1	1.7	1.9
46.3%	47.9%	47.3%	46.3%	47.4%	47.4%	48.1%	48.9%	50.0%
\$18.76	\$17.48	\$16.87	\$16.60	\$17.11	\$16.29	\$16.15	\$15.34	\$14.82
13,464	13,149	13,738	12,841	12,662	12,159	11,564	11,292	10,369
16,365	15,349	15,592	15,504	15,071	14,966	14,278	14,071	13,941
68,020,197	66,578,540	69,179,641	65,459,278	66,216,910	63,877,116	63,344,706	59,427,973	56,279,231
48.5%	55.5%	67.6%	71.2%	82.0%	73.8%	87.4%	75.1%	76.2%
10.4	9.7	5.8	9.2	7.7	9.3	2.5	4.4	8.4
41.1%	34.8%	26.6%	19.6%	10.3%	16.9%	10.1%	20.5%	15.4%
59,892,583	59,326,853	62,451,319	59,915,187	59,517,861	57,027,035	57,726,273	53,685,378	51,327,508
5,879	5,685	5,879	5,939	6,010	5,883	5,630	5,650	5,596
3,325,308	3,275,144	3,232,687	3,163,968	3,082,382	2,986,545	2,900,856	2,814,403	2,749,680
16,292	15,797	14,569	14,157	12,917	12,845	12,671	12,510	12,377

(d) Includes non-Edison owned renewable /alternative sources.

Directors and Officers

Board of Directors

Howard P. Allen,

Chairman of the Board and Chief Executive Officer

Roy A. Anderson,

Chairman of the Executive Committee, Lockheed Corporation, Burbank, California

Norman Barker, Jr.,

*Former Chairman of the Board, First Interstate Bank of California,
and Vice Chairman of the Board, First Interstate Bancorp, Los Angeles, California*

H. Frederick Christie,

President

Warren Christopher,

Senior Partner, Law Firm of O'Melveny & Myers, Los Angeles, California

Camilla C. Frost,

Chairman of the Board of Trustees, Los Angeles County Museum of Art, Los Angeles, California

Walter B. Gerken,

*Chairman of the Board and Chief Executive Officer, Pacific Mutual Life Insurance Company,
Newport Beach, California*

William R. Gould,

*Chairman of the Board Emeritus and Consultant
(Retired Chairman of the Board and Chief Executive Officer,
Southern California Edison Company), Long Beach, California*

Joan C. Hanley,

General Partner and Manager, Miramonte Vineyards, Rancho California, California

Jack K. Horton,

*Chairman of the Executive Committee and Consultant
(Retired Chairman of the Board and Chief Executive Officer,
Southern California Edison Company), Los Angeles, California*

Carl F. Huntsinger,

*President and Chief Executive Officer, DAE Holding, Inc.
(Citrus Production), Ojai, California*

(1) T. M. McDaniel, Jr.,

Retired President, Southern California Edison Company, San Marino, California

J. J. Pinola,

*Chairman of the Board and Chief Executive Officer,
First Interstate Bancorp, Los Angeles, California*

James M. Rosser,

President, California State University at Los Angeles, Los Angeles, California

Henry T. Segerstrom,

*Managing Partner, C. J. Segerstrom & Sons (Real Estate Development),
Costa Mesa, California*

E. L. Shannon, Jr.,

*Chairman of the Board and Chief Executive Officer, Santa Fe International Corporation (Oil Service, Engineering,
Petroleum Exploration and Production), Alhambra, California*

H. Russell Smith,

*Chairman of the Executive Committee,
Avery International (Manufacturer of Self-Adhesive Products), Pasadena, California*

Edward Zapanta, M.D.,

Physician and Neurosurgeon, Monterey Park, California

⁽¹⁾Mr. McDaniel has chosen not to stand for re-election to the Board of Directors in 1986.

Executive Officers

Howard P. Allen,
Chairman of the Board and Chief Executive Officer

H. Frederick Christie,
President

John E. Bryson,
Executive Vice President and Chief Financial Officer

David J. Fogarty,
Executive Vice President

⁽¹⁾Michael R. Peevey,
Executive Vice President

P. L. Martin,
Senior Vice President

L. T. Papay,
Senior Vice President

Kenneth P. Baskin,
Vice President (Nuclear Engineering, Safety and Licensing)

Glenn J. Bjorklund,
Vice President (Engineering and Construction)

Robert H. Bridenbecker,
Vice President (Fuel Supply)

John R. Bury,
Vice President and General Counsel

Richard K. Bushey,
Vice President and Controller

Robert Dietch,
Vice President (Advanced Engineering)

C. E. Hathaway,
Vice President (Human Resources)

Joe T. Head, Jr.,
Vice President (Power Supply)

Charles B. McCarthy, Jr.,
Vice President (Customer Service)

Edward A. Myers, Jr.,
Vice President (System Development)

Michael L. Noel,
Vice President and Treasurer

Harold B. Ray,
Vice President and Site Manager, San Onofre Nuclear Generating Station

Robert E. Umbaugh,
Vice President (Material and Information Services)

Honor Muller,
Secretary

⁽¹⁾Mr. Peevey was elected Executive Vice President effective January 1, 1986.

Distribution of Record Shareholders and Shares as of December 31, 1985	Shareholders				Shares			
	Preferred	%	Common	%	Preferred	%	Common	%
Total Shareholders	29,537	100.0	163,428	100.0	19,373,449	100.0	216,676,897	100.0
<i>Class of Investor</i>								
Males	5,392	18.3	37,686	23.1	902,486	4.7	16,859,084	7.8
Females	11,654	39.4	56,400	34.5	1,773,009	9.2	21,265,518	9.8
Joint Accounts	7,832	26.5	46,272	28.3	1,576,697	8.1	19,700,060	9.1
Fiduciaries	2,855	9.7	19,291	11.8	622,565	3.2	8,670,585	4.0
Religious, Charitable, Fraternal and Educational Institutions	171	0.6	526	0.3	77,276	0.4	844,507	0.4
Financial Institutions	608	2.0	1,126	0.7	11,896,881	61.4	145,345,833	67.1
Other	1,025	3.5	2,127	1.3	2,524,535	13.0	3,991,310	1.8
<i>Amount of Holdings</i>								
1 to 99 shares	12,113	41.0	38,071	23.3	345,032	1.8	1,437,597	0.7
100 shares	6,480	21.9	10,110	6.2	648,000	3.3	1,011,000	0.5
101 to 499 shares	7,653	25.9	76,010	46.5	1,877,664	9.7	19,736,452	9.1
500 to 999 shares	1,799	6.1	21,456	13.1	1,077,188	5.6	14,317,397	6.6
1,000 or more shares	1,492	5.1	17,781	10.9	15,425,565	79.6	180,174,451	83.1
<i>Geographical Location</i>								
Service Territory	7,943	26.9	39,545	24.2	2,015,743	10.4	29,522,792	13.6
Remainder of California	9,703	32.9	47,433	29.0	2,776,080	14.3	47,225,199	21.8
United States (except California) and Possessions	11,836	40.1	75,861	46.4	14,574,138	75.3	139,596,133	64.4
Foreign Countries	55	0.1	589	0.4	7,488	—	332,773	0.2

1986 Annual Shareholders' Meeting:

The annual meeting of shareholders of Southern California Edison Company will be held at 10 a.m., Thursday, April 17, 1986, at the Company's Corporate Headquarters, 2244 Walnut Grove Avenue, Rosemead, California 91770. Telephone (818) 302-1212.

For Investor Relations:

Individual Shareholders contact:
Southern California Edison Company
Secretary's Department—Room 240
Post Office Box 400
Rosemead, California 91770
Telephone (818) 302-1997

Institutional Investors contact:

Manager, Investor Relations
Telephone (818) 302-2515
Assistant Treasurer
Telephone (818) 302-1090

Stock Transfer Agent:

Southern California Edison Company
Secretary's Department—Room 240
Post Office Box 400
Rosemead, California 91770
Telephone (818) 302-1393 or
(818) 302-1936

**Dividend Reinvestment and
Stock Purchase Plan Agent:**

Southern California Edison Company
Secretary's Department—Room 240
Post Office Box 400
Rosemead, California 91770
Telephone (818) 302-1852 or
(818) 302-1995

Registrar of Stock:

Security Pacific National Bank
Los Angeles, California

Stock Exchange Listings:

Common Stock:
New York Stock Exchange
Pacific Stock Exchange
London Stock Exchange

Preferred and Preference Stocks:

American Stock Exchange
Pacific Stock Exchange

Ticker Symbol:

SCE (Common Stock)

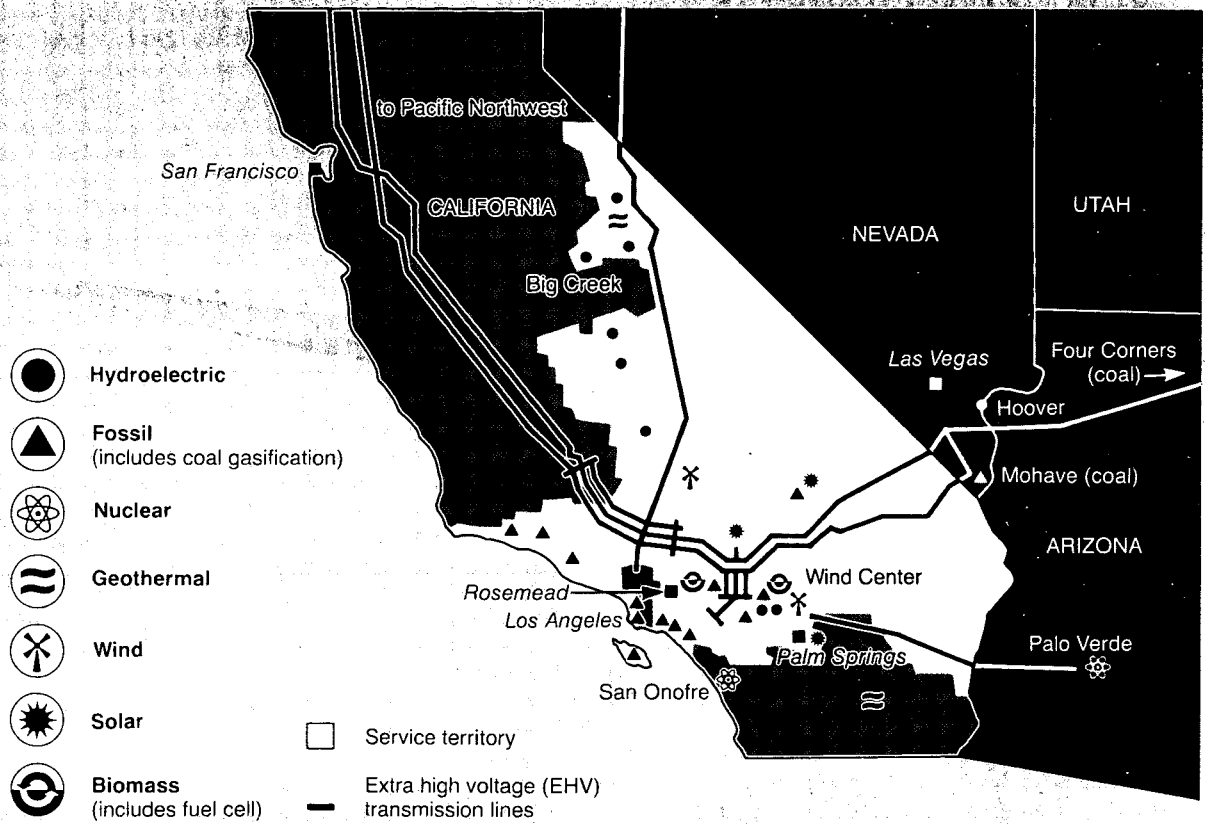
Newspaper Stock Table Listing:

SCEd

Statistical Supplement:

A comprehensive financial and statistical supplement to this report is available in limited quantity. A copy may be requested by writing to the Manager of Investor Relations, Southern California Edison Company, P.O. Box 800, Rosemead, California 91770.

This Annual Report and the statements and statistics contained herein have been assembled for general informative purposes and are not intended to induce, or for use in connection with, any sale or purchase of securities. Under no circumstances is this report or any part of its contents to be considered a prospectus, or as an offer to sell, or the solicitation of an offer to buy, any securities.



Southern California Edison serves more than 9½ million people in a 50,000 square-mile service territory.

Southern California Edison Company provides electric service in a 50,000 square-mile area of Central and Southern California. This area, which has a population of more than 9½ million people, includes some 800 cities and communities.

Edison's gross investment in utility plant totals approximately \$14.0 billion. Area generating capacity at peak during 1985 totaled 17,776 megawatts (MW), which included 14,765 MW of Company-owned facilities and 3,011 MW of capacity from other sources. Of the Company-owned facilities, 70 percent was comprised of oil- and gas-fired generating units. Edison's interest in coal-fired generating units accounted for another 11 percent, and 6 percent was in hydroelectric generation. The Company's interest in a nuclear generating station accounted for the remaining 13 percent.

The Company, incorporated in 1909 under the laws of California, is a public utility and its retail operations

are subject to regulation by the California Public Utilities Commission which has the authority, among other things, to establish retail rates and to regulate security issuances, accounting and depreciation. The Company's resale operations are subject to regulation by the Federal Energy Regulatory Commission as to rates on sales for resale, as well as to other matters, including accounting and depreciation.

The Company's planning and siting of new plant construction are subject to the jurisdiction of the California Energy Commission. Edison also is subject to various governmental licensing requirements, to Securities and Exchange Commission filing and disclosure requirements and to certain other federal, state and local laws and regulations, including those related to nuclear energy and nuclear plant construction, environmental protection, fuel supplies and land use.



Southern California Edison Company
2244 Walnut Grove Avenue
Rosemead, California 91770
(818) 302-1212

San Diego Gas & Electric
Post Office Box 1831
San Diego, California 92112

1980	Compound Annual Growth Rate 5 Years	1979	1978	1977	1976	1975	Compound Annual Growth Rate 10 Years
	(%)						(%)
\$ 308.8	3.5	\$ 218.9	\$ 180.2	\$ 171.3	\$ 128.5	\$ 106.3	13.2
\$ 379.6	1.0	\$ 304.5	\$ 215.8	\$ 224.3	\$ 178.3	\$ 139.6	11.1
\$ (70.8)	—	\$ (85.6)	\$ (35.6)	\$ (53.0)	\$ (49.8)	\$ (33.3)	—
.8	—	.7	.8	.8	.7	.8	—
\$ 732.3	5.7	\$ 640.1	\$ 573.1	\$ 572.6	\$ 489.6	\$ 440.5	8.2
36,469,483	8.9	31,188,237	27,592,809	22,648,992	19,281,308	17,000,000	12.6
\$ 16.06	5.2	\$ 17.35	\$ 17.41	\$ 17.36	\$ 16.72	\$ 16.17	2.5
11.6	—	7.3	7.3	6.7	6.8	11.3	—
\$ 178.1	6.3	\$ 200.1	\$ 200.3	\$ 205.5	\$ 175.8	\$ 122.3	7.0
4.5%	—	10.0%	11.6%	11.0%	12.3%	6.0%	—
6.0%	—	10.4%	11.4%	13.4%	12.7%	5.9%	—
(13.1)%	—	4.3%	3.9%	(2.3)%	5.6%	(14.3)%	—
\$ 1.01	26.3	\$ 1.80	\$ 2.02	\$ 2.32	\$ 2.14	\$ 0.97	12.9
156.8%	—	83.1%	71.5%	55.9%	56.5%	124.9%	—
\$15¼-\$10	—	\$15⅞-\$12¾	\$16⅜-\$14¼	\$16-\$13¾	\$15-\$11⅞	\$13⅜-\$10	—

Quarterly Common Stock Data

Year Ended December 31	1985				1984			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Market price								
High	24	28⅞	27½	28¼	21⅜	19¼	21	23¾
Low	21½	23⅞	24⅞	25	17¾	18	17⅝	20¼
Dividends declared	52.5¢	56¢	56¢	56¢	49¢	52.5¢	52.5¢	52.5¢

Additional Information

Publications: Other publications are provided free of charge, including a combination Financial Forecast to 1990 and Statistical Report for 1975-1985; Form 10K, the annual report to the Securities and Exchange Commission; a Shareholder Information Handbook; and Toward 2000: New Strategies, a booklet explaining the company's strategic plan.

For copies, write or call:
Office of the Secretary
San Diego Gas & Electric
P.O. Box 1831
San Diego, California 92112
(619) 696-2020

Shareholder inquiries about stock holdings:
Write or call the Office of the Secretary

Financial community inquiries: Call Jennifer Lewis,
Manager of Investor Relations (619) 696-4487

Utility customer inquiries on general energy
subjects: Call (619) 239-SDGE

Utility customer inquiries on specific bill or service-
related subjects: Call the number listed on the bottom
of your SDG&E bill.

Shareholder Reference Guide

Selected Financial Data

At December 31	1985	1984	1983	1982	1981
Current assets*	\$ 366.2	\$ 393.8	\$ 267.3	\$ 303.9	\$ 302.4
Current liabilities*	\$ 399.7	\$ 348.0	\$ 426.4	\$ 440.5	\$ 450.5
Working capital*	\$ (33.5)	\$ 45.8	\$ (159.1)	\$ (136.6)	\$ (148.1)
Working capital ratio	.9	1.1	.6	.7	.7
Long-term debt*	\$ 967.1	\$1,034.8	\$1,036.4	\$ 785.1	\$ 727.2
Common shares outstanding	55,822,762	54,063,592	51,693,662	48,266,144	41,499,034
Book value per common share	\$ 20.65	\$ 19.48	\$ 18.52	\$ 16.94	\$ 16.20
Price/Earnings ratio	8.3	7.6	6.1	5.9	5.3

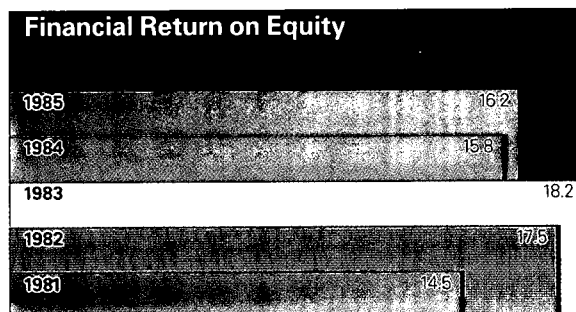
For Year Ended December 31

Capital expenditures**	\$ 241.2	\$ 197.8	\$ 292.0	\$ 252.8	\$ 209.7
Pre-tax income/revenue	22.7%	19.8%	18.7%	15.3%	10.2%
Return on equity	16.2%	15.8%	18.2%	17.5%	14.5%
Effective federal tax rate	44.5%	38.7%	31.2%	24.0%	4.7%
Earnings per common share	\$ 3.25	\$ 3.01	\$ 3.20	\$ 2.90	\$ 2.34
Dividend payout ratio (declared)	68.1%	68.8%	60.7%	62.4%	71.1%
Price range of common shares	\$28 ³ / ₈ -\$21 ¹ / ₂	\$23 ³ / ₄ -\$17 ⁵ / ₈	\$22-\$17	\$17 ⁷ / ₈ -\$11 ³ / ₄	\$14-\$11

*In millions of dollars.

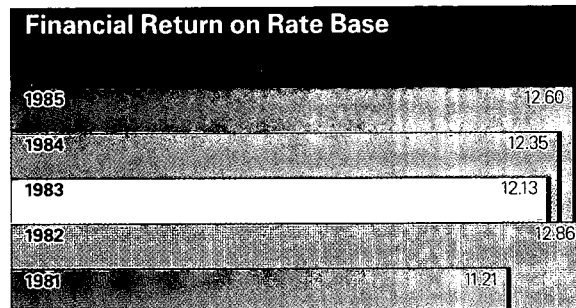
**Excluding allowance for funds used during construction.

Financial return on equity is measured by earnings applicable to common shares divided by average common equity.



(weighted average) (by percent)

Financial return rate base is operating income divided by average rate base. In 1985, it reached its highest point since 1982 at 12.6 percent.



(weighted average) (by percent)

Shareholder Profile

There were 81,471 common stock shareholders of record and 12,922 preferred and preference shareholders as of December 31, 1985. There are thousands of other individual shareholders whose accounts are held by the securities dealers and nominees.

Common stock shareholders:

Who

Joint Accounts	28,719
Women	24,392
Men	17,332
Fiduciaries	9,254
Securities dealers, nominees, other	1,774

Where

United States, except California	42,285
California, except SDG&E service area	24,292
SDG&E service area	14,686
Foreign countries	208

How much

1 - 99 shares	15,248
100 - 300	46,058
301 - 500	10,148
501 - 1000	6,883
1001 or more shares	3,134

Executive Offices

San Diego Gas & Electric Company
101 Ash Street
Post Office Box 1831
San Diego, California 92112
(619) 696-2000

Annual Meeting in 1986

11 a.m., April 22
Electric Building Auditorium
101 Ash Street
San Diego, California

Stock Listing and Trading Information

Common stock: Ticker symbol is SDO. Listed on New York and Pacific stock exchanges. Newspaper listing is SDieGs.

Preferred and preference stocks: Ticker symbol is SDO. Listed on the American and Pacific stock exchanges (except for the 4.60% preferred series and the \$8.25, \$9.125 and \$15.44 preference series, which are not listed). Newspaper listing is SDgo.

Transfer Agents and Registrars

The transfer agent has primary responsibility for stock transfers and the cancellation and issuance of stock certificates. The agent should be contacted directly about these subjects.

Common stock transfer agents:

California First Bank
8155 Mercury Court
P.O. Box 2529
San Diego, California 92112
(619) 230-4487

First Interstate Bank of California
c/o Schroder Trust Company
One State Street
New York, New York 10015
(also registrar for the common stock)

Preferred stock transfer agents:

California First Bank
(listed above)

Preference stock transfer agents:

First Interstate Bank
(listed above)

Common Stock Investment Plan

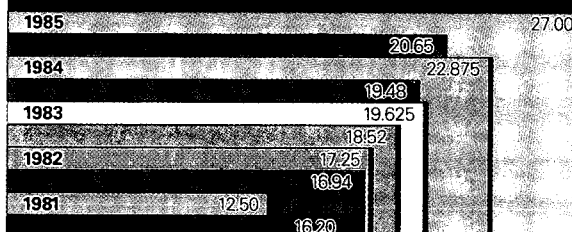
SDG&E offers its common stock shareholders a Common Stock Investment Plan that allows them to invest automatically all or a portion of their quarterly dividends on directly-held shares to purchase additional shares without paying brokerage fees.

The plan also allows optional cash investments of as little as \$25 per investment to a maximum of \$5,000 per calendar quarter.

For a plan prospectus, write or call:

Office of the Secretary
San Diego Gas & Electric
P.O. Box 1831
San Diego, California 92112
(619) 696-2020

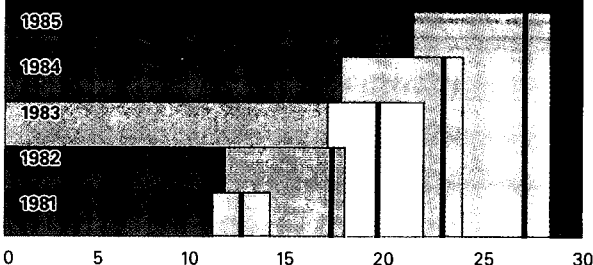
Common Stock Data



Market Price
Book Value
(in dollars, at December 31)

The price of a share of common stock closed the year at \$27—significantly above book value.

Common Stock Price Trend



Low Year-End High
(in dollars)

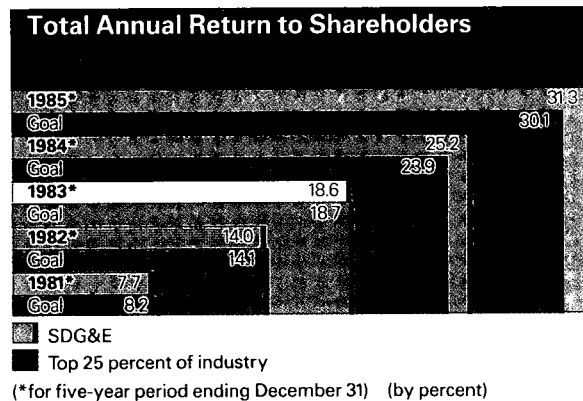
The common stock price rise reflects the company's general financial improvement and the success of the active program to increase institutional investor interest.



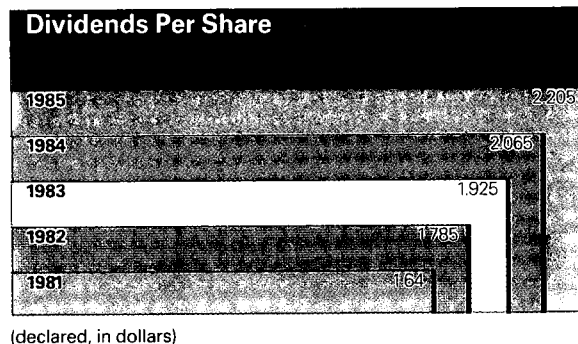
Tom Page addressed several hundred Japanese institutional investors at a meeting in Tokyo.

The continuing growth in the number of our utility customers is very attractive to investors.”

Total overall return to shareholders exceeded management's goal of staying in the top 25 percent of the industry.



Dividends were increased in 1985 for the ninth consecutive year. For the fourth year in a row, the rate of increase exceeded the rate of inflation.



Stock price appreciation and dividend increases are components of the company's total overall return to shareholders, a primary financial goal.

In 1985, the stock price rose from \$22.50 on January 1 to \$27 on December 31 and dividends were increased for the ninth consecutive year, by 6.7 percent, higher than the rate of inflation.

One reason for the stock price increases is stock trades by the company's institutional holders, says Lee Haney, vice president and treasurer. "They will buy and sell thousands of shares of the company's stock in a day.

Investors' Meetings:

"Although the number of institutional shareholders has increased from 87 in 1984 to 127 in 1985, we would like to have even more institutional interest. We are continuing to meet with prospective shareholders, not only in the United States but in other countries, such as Japan, where there is considerable interest in the American energy industry."

In October 1985, Chairman Thomas Page spoke at a Japanese Institutional Investors Conference in Tokyo that was sponsored by *Institutional Investor* magazine. He was invited to speak by panel coordinator Ernie Liu of Goldman-Sachs. Page was one of only two representatives of the U.S. utility industry. Other speakers came from different industries or different countries.

A few months later, a group of interested Japanese investors traveled to San Diego to meet with management and to learn more about the company.

Survey Results:

"Several years ago we set out to make the company better known to the key analysts," says Haney. "We did that very well, a survey taken in 1985 told us.

"That survey also revealed that the company is not as well known among portfolio managers. They manage pension funds for individuals and corporations, thus are the key to increasing the institutional purchases of our stock. Therefore, in 1986, we are going to focus more on making these managers aware of company goals and results.

"The survey confirmed that the subjects of most interest to the institutional investing community were the regulatory environment and the customer growth in our utility service territory. The continuing growth in the number of our utility customers is very attractive to investors."



The Share Forum

The Share Forum is an organization of SDG&E shareholders whose members receive additional information about the company through meetings with management, tours of utility facilities and periodic mailings. There are nearly 10,000 members.

In 1985, activities of The Share Forum included meetings with management in San Francisco and Irvine, California, and a tour of the Heber geothermal research plant.

For information on joining The Share Forum, write the Office of the Secretary, San Diego Gas & Electric, P.O. Box 1831, San Diego, California 92112.

Responsibility Report for the Financial Statements

The company is responsible for the financial statements and other data in this annual report.

To meet its responsibility for the reliability of the financial statements, the company has developed a system of internal accounting controls and engages a firm of independent public accountants. The board of directors of the company carries out its responsibility for the financial statements through its audit committee, composed of directors who are not officers or employees of the company.

Management maintains the system of internal accounting controls, which it believes is adequate to provide reasonable, but not absolute, assurance that its assets are safeguarded, transactions are executed in accordance with its objectives and the financial records and reports are reliable for preparing the financial statements in accordance with generally accepted accounting principles. The concept of reasonable assurance recognizes that the cost of a system of internal accounting controls should not exceed the benefits derived and that management makes estimates and judgments of these cost/benefit factors. The system of internal accounting controls is supported by an extensive program of internal audits,

selection and training of qualified personnel, and written policies and procedures.

The company's independent public accountants, Deloitte Haskins & Sells, are engaged to examine the company's financial statements in accordance with generally accepted auditing standards for the purpose of expressing their opinion as to whether the company's financial statements are presented fairly in accordance with generally accepted accounting principles applied on a consistent basis.

The audit committee of the board of directors meets periodically with management, the independent public accountants and the internal auditors to ensure that each is carrying out its responsibilities, and to discuss auditing, financial reporting and internal control matters. The independent public accountants and the company's internal auditors have full and free access to the audit committee throughout the year.

The management of the company has prepared the financial statements and other data in this annual report. In the opinion of the company, the financial statements, which include amounts based on estimates and judgments of management, have been prepared in conformity with generally accepted accounting principles.



Robert E. Parsley
Vice President and Controller

Auditors' Opinion

Deloitte Haskins & Sells
Certified Public Accountants
701 B Street
San Diego, California 92101

To the Shareholders and Board of Directors of San Diego Gas & Electric Company:

We have examined the financial statements and schedules of San Diego Gas & Electric Company (pages 19 to 33) for the years ended December 31, 1985, 1984 and 1983. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 6 to the financial statements, the California Public Utilities Commission is investigating the reasonableness of the costs incurred to construct San Onofre Nuclear Generating Station Units 2 and 3. The outcome of this investigation cannot presently be determined; however, the final decision could result in the reversal of revenues previously recorded.

In our opinion, subject to the effects on the 1985 and 1984 financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the above-mentioned financial statements and schedules present fairly the financial position of the company at December 31, 1985 and 1984 and the results of its operations and its sources of funds for construction for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.



February 10, 1986

Board of Directors

Thomas A. Page*

Chairman, President and Chief Executive Officer of SDG&E.

Clair W. Burgener*

President of Burgener Properties, Inc., a real estate and property development firm.

Malin Burnham*

Chairman of John Burnham & Co., a mortgage loan, real estate and insurance firm.

David M. DeMotte*

President of Dave's Rough Country Off Road Center, a distributor of specialty equipment for the automotive aftermarket.

Daniel W. Derbes

President of Allied-Signal International Inc. and Executive Vice President of Allied-Signal Inc.

William D. McElroy*

Professor of Biology at University of California at San Diego.

Ralph R. Ocampo

San Diego physician and surgeon.

Burt F. Raynes**

President of Raynes Engineering Corporation, a mechanical engineering and product development firm.

Charles R. Scott

President and Chief Executive Officer of Intermark, Inc., a La Jolla-based operating and holding company.

O. Morris Sievert*

President of Deposition Technology, Inc., a manufacturer of high technology materials and a subsidiary of Material Science Corp., a major steel coil coating company.

Fred C. Stalder

Private investor; former President, Chairman and Chief Executive Officer of Central Savings and Loan Association.

Catherine Fitzgerald Wiggs

Executive Vice President, Personnel and member of the Management Executive Committee of The Broadway Stores, Inc., Division of Carter Hawley Hale Stores, Inc.

*Member of the executive committee

**Will retire from the board on April 22, 1986

Committees of the Board

Audit

This committee recommends an independent auditor and reviews the overall plan of the audit, financial statements, audit results, scope of internal audit procedures and the auditors' evaluation of internal controls.

Executive

This committee is empowered to act in place of the full board, except in certain transactions for various board responsibilities which are reserved for the board itself.

Executive Salary Review

This committee reviews the salaries and other forms of compensation of officers of the company and makes compensation recommendations to the board.

Finance

This committee reviews the general investment policy and investment performance for the Pension Plan and Savings Plan and counsels with management concerning the company's capital requirements, proposed financing programs and capital risk exposure analyses.

Nominating

This committee considers and recommends nominees to the board, criteria for board and committee composition and membership and directors' compensation.

Strategic Planning

This committee works with management in the development, review and evaluation of a strategic plan, including a plan to develop or find nonutility businesses and business opportunities. It reports and makes recommendations to the board.

Stephen L. Baum, 45

Vice President and
General Counsel

Stephen Baum joined SDG&E in 1985. Formerly, he was senior vice president and general counsel for the Power Authority of the State of New York; general attorney of Orange & Rockland Utilities, Inc.; and an associate of Curtis Mallet-Prevost Colt and Mosle.

Donald E. Felsing, 38

Vice President—
Operation Services

Donald Felsing was named the head of operation services in April 1985 after serving as vice president of the gas division and of customer service administration. Operation services is responsible for all company facilities, construction, distribution engineering, fleet management and land and environmental. Felsing joined SDG&E in 1972.

Ronald K. Fuller, 48

Vice President—Governmental
and Regulatory Services

Ronald Fuller was elected vice president of regulatory services in 1983 and governmental services was added to the division in 1984. He was manager of the company's governmental relations operations in Washington, D.C. for eight years. He joined the company in 1974.

John E. Hamrick, 59

Vice President—
Customer Service

John Hamrick was elected a vice president in 1973 and has headed the customer service division since 1983. The activities of the seven customer service centers are his responsibility. Hamrick joined the company in 1971.

R. Lee Haney, 46

Vice President and Treasurer

Lee Haney was elected a vice president in 1983 after serving as manager of financial services and then treasurer throughout the financial recovery period in the early 1980s. Haney joined SDG&E in 1972.

Chris Harlow, 41

Vice President—Corporate
Strategy and Systems

Chris Harlow was given the expanded responsibility for corporate strategy and systems in April 1985. He had been vice president of information services since 1981, when he joined the company.

James C. Holcombe, 40

Vice President—Fuel
and Power Contracts

James Holcombe, vice president of power supply since 1983, became the head of the new fuel and power contracts group in April 1985. He has extensive background with the electric utility, serving as power supply division manager and electric operations manager. He joined the company in 1967.

Richard L. Manning, 54

Vice President—
Public Relations

Richard Manning has been vice president—public relations since he joined SDG&E in 1981 after serving as manager of public affairs for the Western Oil & Gas Association. His responsibilities include managing corporate communications.

Robert E. Parsley, 64

Vice President and Controller

Robert Parsley was elected a vice president in April 1985. He has been the controller and chief accounting officer of SDG&E since 1966. All of the accounting services of the company are his responsibility. Parsley joined the company in 1941.

Ronald W. Watkins, 44

Vice President—
Administrative Services

Ronald Watkins has headed the administrative services division since April 1985. He was elected vice president in 1979. Prior responsibilities included the gas division, resource management and resource planning. He joined the company in 1964.

George A. F. Weida, 49

Vice President—
Human Resources

George Weida joined SDG&E in 1983 as a vice president. He was named head of the human resources division in 1984. Previously, he was head of human resources for several other major U.S. corporations.

William J. Karnes, 63

Secretary

William Karnes was elected secretary of SDG&E in 1974 and he is responsible for shareholder services. This includes the administration of the Common Stock Investment Plan, responding to inquiries by shareholders and recording board and shareholder meetings. Karnes joined the company in 1950.

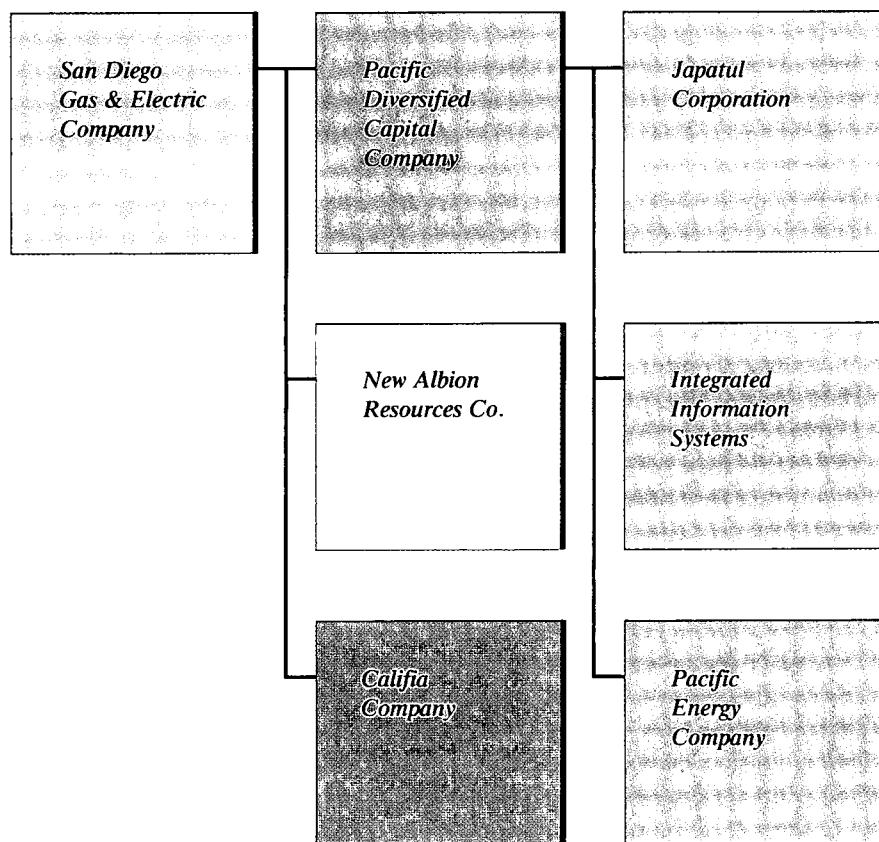
San Diego Gas & Electric Company is an investor-owned utility with 4,860 employees. It was founded in 1881.

The company purchases, generates and distributes electricity to 900,000 customers in San Diego County and the southwestern section of Orange County. It also purchases and distributes natural gas to 575,000 customers in San Diego County.

SDG&E has three subsidiaries: Pacific Diversified Capital Company, a nonutility operations management company; New Albion Resources Co., an energy resource discovery and development company; and Califa Company, a financing company.

Pacific Diversified also has three subsidiaries: Japatul Corporation, a real estate development company; Integrated Information Systems, a computer services company; and Pacific Energy Company, an energy services investment company.

The utility's service territory covers 4,100 square miles and has a population of more than two million. Service centers are regionally located in Southern California to give customers access to personal service.



Officers

Gary D. Cotton, 45

Senior Vice President—
Electric Operations

Gary Cotton was elected senior vice president in April 1985 and given the responsibility for managing Electric Operations. Cotton joined SDG&E in 1975. He was elected vice president—engineering in 1979.

Alton T. Davis, 48

Senior Vice President—
Gas Operations

Alton Davis was elected senior vice president in April 1985 and given the responsibility for Gas Operations. Davis joined SDG&E in 1968. He was elected vice president of the gas division in 1976 and group vice president in 1981.

Richard Korpan, 44

Senior Vice President—Finance
and President, Pacific Diversified
Capital Company

Richard Korpan was elected senior vice president in April 1985. He serves as the company's chief financial officer and is responsible for developing the non-utility operations for SDG&E. He joined the company as treasurer in 1979 and was elected a group vice president in 1981.

Harold A. Monsor, 64

Senior Vice President—
Consultant to the President

Harold Monsor was elected senior vice president in April 1985. He joined the company as a vice president in 1983 after serving as a senior officer in several large domestic and international U.S. corporations and heading his own management consulting company.

Thomas A. Page, 52

Chairman, President and
Chief Executive Officer

Thomas Page was elected president and chief executive officer in 1981 and chairman in 1983. A certified public accountant and a licensed professional engineer with an extensive management background, he joined SDG&E in 1978 as a senior officer.

Jack E. Thomas, 53

Executive Vice President—
Utility Operations

Jack Thomas was elected executive vice president in March 1985 and given the responsibility of overseeing all gas and electric utility operations. In 1971, he was elected vice president of the electric division and in 1980 was elected group vice president—customer service. He joined SDG&E in 1957 as an engineer.

The adjusted financial information in this schedule is reported in average 1985 dollars. It reflects the effect of changes in the specific prices (current costs) of property, plant and equipment expressed in units of constant purchasing power. For most of the company's property, plant and equipment, current cost amounts were determined by applying the Handy-Whitman Index of Public Utility Construction Costs to the applicable historical costs. Other current cost information is expressed in average 1985 dollars as measured by the Consumer Price Index for all Urban Consumers.

a. Income from operations

Current cost income from operations for 1985 is less than income from operations reported in the Statement of Income on page 19. This is because depreciation expense on a current cost basis exceeded depreciation expense in the Statement of Income by \$91 million.

Fuel inventories, the cost of fuel used in generation and gas purchased for resale have not been restated from their historical cost in nominal dollars. By means of adjustment clauses, regulation limits the recovery of fuel and purchased gas costs to actual cost. For this reason, fuel inventories are effectively monetary assets. In addition, since only historical costs are deductible for income tax purposes, no adjustments have been made to tax expense.

b. Purchasing power gain

The purchasing power gain on net amounts owed is an economic benefit that results from being able to repay those amounts with cheaper dollars.

c. Specific prices vs. general prices

During 1985, the specific prices (current cost) of property, plant and equipment, net of accumulated depreciation, increased by \$43 million. General inflation increased costs of property, plant and equipment, net of accumulated depreciation, by \$158 million.

d. Net assets

Net assets include property, plant and equipment and all other items as reported in the Balance Sheets on page 20. Property, plant and equipment are presented at net recoverable cost because the regulatory process allows rate recovery of only the historical cost of utility plant.

At December 31, 1985, the current cost of property, plant and equipment, net of accumulated depreciation, was \$4.2 billion (measured in average 1985 units of purchasing power). That amount is higher than the historical cost amount of \$2.5 billion for utility and nonutility property, plant and equipment, net of accumulated depreciation. Therefore, it is reasonable to expect income from operations on a current cost basis for 1986 to remain significantly below that reported on a historical cost basis.

Five-Year Comparison of Selected Financial Data Adjusted for Effect of Changing Prices (Unaudited)

(In Thousands of Dollars Except Per Share Amounts)

For the Years Ended December 31	1985	1984	1983	1982	1981
Total operating revenue					
As reported	\$1,738,702	\$1,620,701	\$1,530,207	\$1,430,948	\$1,159,662
Adjusted for general inflation	1,738,702	1,678,527	1,652,254	1,594,782	1,371,671
Income from operations (excluding adjustment to net recoverable cost)					
As reported a	\$ 202,722	\$ 183,467	\$ 187,370	\$ 157,303	\$ 110,156
Adjusted for specific price changes	111,581	87,860	98,151	100,480	50,959
Purchasing power gain from holding net monetary liabilities					
As reported b	\$ 47,421	\$ 54,168	\$ 50,229	\$ 52,327	\$ 97,485
Excess of increase in general price level over increase in specific prices of net assets after adjustment to net recoverable cost					
As reported c	\$ 3,631	\$ 6,239	\$ 795	\$ 24,767	\$ 98,907
Net assets at year-end at net recoverable cost					
As reported d	\$1,313,984	\$1,213,905	\$1,118,607	\$ 978,441	\$ 833,379
Restated	1,291,931	1,236,555	1,185,966	1,072,280	953,466
Per share information:					
Income from operations (after preferred dividend requirements and excluding adjustment to net recoverable cost)					
As reported	\$ 3.25	\$ 3.01	\$ 3.20	\$ 2.90	\$ 2.34
Adjusted for general inflation	1.59	1.19	1.37	1.57	.74
Cash dividends declared					
As reported	\$2.205	\$ 2.065	\$ 1.925	\$1.785	\$ 1.64
Adjusted for general inflation	2.205	2.139	2.079	1.989	1.94
Market price at year-end					
As reported	\$27.00	\$22.875	\$19.625	\$17.25	\$12.50
Adjusted for general inflation	26.55	23.361	20.834	19.01	14.31
Average Consumer Price Index					
	322.2	311.1	298.4	289.1	272.4

8 Quarterly Financial Data (Unaudited)

These amounts are unaudited, but in the opinion of the company reflect all adjustments necessary for a fair presentation.

(In Thousands Except Per Share Amounts)

Quarter Ended	March 31	June 30	September 30	December 31
1984				
Operating revenues	\$388,855	\$374,836	\$417,683	\$439,327
Operating expenses	332,305	315,243	351,755	369,848
Operating income	56,550	59,593	65,928	69,479
Other income	15,934	8,453	4,946	9,860
Net interest charges	23,877	25,776	27,547	30,076
Net income (before preferred dividend requirements)	48,607	42,270	43,327	49,263
Preferred dividend requirements	6,169	6,026	5,989	5,988
Earnings applicable to common shares	\$ 42,438	\$ 36,244	\$ 37,338	\$ 43,275
Average common shares outstanding	51,994	52,489	53,104	53,872
Earnings per common share	\$ 0.82	\$ 0.69	\$ 0.70	\$ 0.80
1985				
Operating revenues	\$447,300	\$403,503	\$433,102	\$454,797
Operating expenses	371,667	337,579	362,918	378,671
Operating income	75,633	65,924	70,184	76,126
Other income	5,090	6,548	6,194	10,237
Net interest charges	29,840	28,720	27,359	27,295
Net income (before preferred dividend requirements)	50,883	43,752	49,019	59,068
Preferred dividend requirements	5,989	5,963	5,923	5,922
Earnings applicable to common shares	\$ 44,894	\$ 37,789	\$ 43,096	\$ 53,146
Average common shares outstanding	54,428	54,952	55,383	55,721
Earnings per common share*	\$ 0.82	\$ 0.69	\$ 0.78	\$ 0.95

*Because these earnings are based on average common shares outstanding during the quarter, the sum of quarterly earnings per share does not equal annual earnings per share.

Notes to Financial Statements

sion and replacement power used while the plant was shut down for the modifications.

The ultimate effect of the California Public Utilities Commission review is not presently determinable; however, management does not expect the effect to be material to the company's financial position.

Nuclear insurance

Public liability claims that could arise from a nuclear incident are currently limited by the Price-Anderson Act to a maximum amount of \$650 million for each licensed nuclear facility. The company and the co-owners of the San Onofre units have purchased primary insurance of \$160 million for this exposure, the maximum amount available in 1985. The remaining \$490 million is provided by secondary financial protection required by the Nuclear Regulatory Commission. This secondary coverage provides for loss sharing among utilities owning nuclear reactors if a costly accident occurred. Under the agreement with the NRC, the company could be assessed retrospective premium adjustments of up to \$6 million a year in the event of nuclear incidents involving any of the licensed reactors in the United States, if the amount of the loss exceeds \$160 million.

In addition to public liability insurance, coverage is provided for property damage and replacement power costs at San Onofre. Primary property damage coverage is provided for losses of up to \$500 million. Additional decontamination liability and excess property damage insurance coverage is also provided (\$610 million at December 31, 1985). Replacement power insurance provides weekly indemnity payments for up to two years, commencing after a waiting period of 26 weeks. These three insurance coverages are provided primarily through mutual insurance companies owned by utilities with nuclear facilities. If losses at any of the nuclear facilities covered by the risk-sharing arrangements were to exceed the accumulated funds available for these insurance programs, the company could be assessed retrospective premium adjustments of up to \$17.5 million per year.

Construction

Approximately \$238 million (excluding AFUDC) is planned to be spent for utility plant construction in 1986. Construction funds held by a trustee (see Balance Sheets, p. 20) represent unspent proceeds from certain first mortgage bonds.

Leases

Nuclear fuel, an office building and a generating facility are financed by long-term capital leases. If they were included on the Balance Sheets, both assets and liabilities would increase by \$242 million at December 31, 1985 and \$244 million at December 31, 1984. Generally accepted accounting principles do not require capitalization of these leases until 1987. Capitalizing these leases would not affect total recorded expenses.

The minimum rental commitments payable in future years under all noncancellable leases are:

(In Millions of Dollars)

1986	\$ 47
1987	45
1988	38
1989	36
1990	27
Thereafter	206
Total future rental commitments	\$399

Rent expense totaled \$24 million in 1985 and 1984 and \$22 million in 1983.

Purchased power contracts

The company is committed to buying electric power under several long-term contracts. The contracts expire on various dates between 1988 and 2013.

At December 31, 1985, the future minimum payments under the contracts were:

(In Millions of Dollars)

1986	\$ 212
1987	240
1988	231
1989	173
1990	119
Thereafter	1,706
Total minimum payments	\$2,681

These payments are fixed charges. The company is required to pay additional amounts for actual deliveries of energy under the contracts.

Total payments, including energy payments, under such contracts were \$158 million in 1985, \$87 million in 1984 and \$101 million in 1983.

6 Contingency Concerning San Onofre Nuclear Generating Station Units 2 & 3

The California Public Utilities Commission is investigating the reasonableness of the costs incurred to construct San Onofre nuclear units 2 and 3. The commission staff has recommended disallowing approximately \$195 million of the almost \$900 million that the company had capitalized as of December 31, 1984. Costs that are disallowed would be excluded from rate base. This would reduce future revenues. In addition, because revenues for 1985 and prior years were based on full capitalization pending a commission decision, a disallowance would probably require reversing revenues previously recorded.

If the disallowance proposed by the staff is agreed to by the commission and if the reversal of revenues is proportional to the cost disallowance, the after-tax effect on earnings through December 31, 1985 would be approximately \$50 million. Since revenues continue to be recorded based on full capitalization, the after-tax effect would increase by approximately \$25 million by the end of 1986 when the commission decision is expected.

If the commission adopts the staff's recommendation, the future revenues, although reduced, would still be sufficient to recover the full capitalized costs of the units. Therefore, write-off of the costs excluded

from rate base would not be required under generally accepted accounting principles currently in effect. However, the Financial Accounting Standards Board is proposing an accounting principle that would require the immediate write-off of the costs excluded from rate base. Although that proposal is being challenged by the utility industry and others, it may become a formal requirement by the end of 1986.

A commission disallowance as large as that proposed by the commission staff, requiring the reversal of revenues, would have a materially adverse effect on the company's earnings in the year of the disallowance. If, in addition, the FASB adopts its proposal, the combined adverse effect of reversing revenues and writing off costs would be material to the company's financial condition in the year of the disallowance.

The company and Southern California Edison Company have submitted extensive evidence, including the testimony of nationally known and highly respected experts in the fields of nuclear power and regulation, to demonstrate that the construction process and costs for these units were reasonable and well managed. The company will vigorously support this position and oppose the staff's recommendations.

Management cannot predict the ultimate outcome of this matter.

7 Other Contingencies and Commitments Southwest Powerlink

Beginning in 1986, the California Public Utilities Commission ordered the company to establish a five-year balancing account for the difference between the cost of energy received over the company's Southwest Powerlink and avoided cost as established by the procedures set forth in the commission's decision. The commission said that any balance accrued in the account above avoided cost at the end of five years would be presumed to have been imprudently incurred, subject to evidentiary hearings. The company would be unable to collect and would have to write off any balance ultimately found imprudent after such hearings. The company would be required to record reserves for potential losses earlier, if and when losses become probable.

The company estimates that any unfavorable balance at the end of the five years could be as high as \$210 million excluding interest. The balance, however, will be significantly affected by several factors, most of which are beyond the company's con-

trol. The calculation of avoided cost will heavily depend upon future natural gas rates for power plant gas as set by the commission. Higher natural gas rates, for example, would reduce any unfavorable balance. Additionally, the amount and price of economy energy available to the company and the physical capacity of the Southwest Powerlink, which is affected by the operations of other interconnected utilities, would affect the balance.

During January 1986, the company applied for a rehearing of the commission's decision. Because of the uncertainty concerning the outcome of the rehearing request and the nature of the process of estimating future balances, management cannot predict the ultimate outcome of this matter.

San Onofre Nuclear Generating Station Unit 1

The California Public Utilities Commission is reviewing the reasonableness of certain expenditures required for San Onofre Nuclear Generating Station Unit 1. These expenditures were for plant modifications mandated by the Nuclear Regulatory Commis-

Notes to Financial Statements

5 Income Taxes

Deferred income taxes arise from timing differences, which result from including income or deductions in the company's income tax returns in a year different than the year they are reported in the financial statements. However, deferred taxes are not provided for those timing differences that are included in both the company's tax return and ratemaking calculations in the same year. At December 31, 1985,

the cumulative net amounts of the timing differences for which deferred taxes have not been provided were approximately \$452 million for federal purposes and \$567 million for state purposes. The company provides deferred taxes for all other differences. In addition, current tax reductions arising from investment tax credits are deferred and recognized over the useful lives of the related property.

Components of Income Tax Expense

(In Thousands of Dollars)

	1985	1984	1983
Current federal income tax	\$112,340	\$ 13,162	\$ 18,204
Current state franchise tax	36,166	25,894	16,905
Total current taxes	148,506	39,056	35,109
Deferred—federal and state taxes			
Regulatory balancing accounts—net	(14,010)	609	(6,615)
Construction projects	(19,277)	8,502	3,582
Tax over book depreciation	37,553	34,490	30,967
Nuclear fuel financing	3,211	(3,234)	8,031
Capitalized nuclear revenue	9,104	(3,303)	(23,090)
Call premium on refunded debt	7,785	(298)	8,775
State franchise tax	(3,678)	(4,514)	(7,623)
Other—net	6,150	(4,497)	(10,891)
Total deferred taxes	26,838	27,755	3,136
Deferred investment tax credits—net	17,346	70,753	61,083
Total income tax expense	\$192,690	\$137,564	\$ 99,328

Federal and state income taxes are allocated between operating income and other income.

Reconciliation of Statutory Federal Income Tax Rate to Effective Rate

(In Thousands of Dollars)

	1985	1984	1983
Income before federal income taxes	\$365,013	\$299,428	\$272,220
Statutory federal income tax rate	46.0%	46.0%	46.0%
Construction costs capitalized	(5.3)	(3.6)	(4.0)
Depreciation	2.9	2.3	0.9
Allowance for funds used during construction	(0.7)	(3.6)	(13.2)
Other—net	1.6	(2.4)	1.5
Effective federal income tax rate	44.5%	38.7%	31.2%

3 Facilities Under Joint Ownership

Interests in electric generating and transmission facilities under joint ownership with other utilities and governmental bodies were as follows at December 31, 1985:

(In Millions of Dollars)

Project	Southwest Powerlink	San Onofre
Ownership interest (%)	89	20
Utility plant in service	\$202	\$1,058
Accumulated depreciation	\$ 10	\$ 100
Construction work in progress	\$ 8	\$ 44

Each participant in the projects must provide its own financing.

The company's share of operating expenses is included in its Statements of Income.

The company's share of future dismantling and decontamination costs for the San Onofre units is currently estimated to be \$78 million. It is expected that this estimate will be revised and that these costs will be recovered in rates over the estimated lives of the plants. Procedures for rate recovery are to be established by the California Public Utilities Commission. These procedures will include placing the amounts collected in a trust fund as they are received.

4 Employee Benefit Plans

A non-contributory, funded pension plan is provided for substantially all employees. Pension costs are based on actuarial determinations and the pension plan is funded on the same basis. A non-contributory, unfunded pension plan for certain officers is also maintained. The accumulated plan benefits and net assets as of the latest benefit information date are presented below:

(In Millions of Dollars)

As of July 1	1985	1984
Actuarial present value of accumulated plan benefits		
Vested	\$135	\$127
Non-vested	21	15
Total	\$156	\$142
Net assets available for benefits	\$226	\$181

An 8 percent rate of return was used to determine the actuarial present value of accumulated plan benefits.

Eligible employees may make a contribution of 1 to 11 percent of their base pay to the company's Savings Plan. The company contributes up to 3 percent of a participant's base compensation. Company contributions are invested in the company's common stock. Employee contributions are invested, as the employees elect, in mutual funds or common stock of the company.

The company contributed approximately \$15 million in 1985 and 1984 and \$17 million in 1983 to these plans.

The company also maintains an employee stock ownership plan funded by tax credits not otherwise available to the company.

1 Summary of Accounting Policies

Utility plant and depreciation

Utility plant represents the buildings, equipment and other facilities used to provide electric and gas service. The cost of utility plant includes labor, material, contract services and other related items and an allowance for funds used during construction. The cost of depreciable retired utility plant plus removal expenses minus salvage value, is charged to accumulated depreciation.

Depreciation expense reflects the straight-line remaining useful life method. The provisions for depreciation approximated the following percentages of average depreciable plant: 4.08 percent in 1985, 4.09 percent in 1984 and 3.97 percent in 1983.

Allowance for funds used during construction

The allowance represents the cost of borrowed and shareholder funds used to finance the construction of utility plant and is added to the cost of utility plant. AFUDC also increases income, partly as an offset to financing costs shown in the Statements of Income, although it is not a current source of cash.

Revenues and regulatory balancing accounts

Revenues consist of billings to customers and the changes in regulatory balancing accounts. Billings to customers are based on meters read on a cycle basis throughout each month. Balancing accounts, which are authorized by the California Public Utilities Commission, eliminate earnings fluctuations resulting from changes in consumption levels for electricity and gas and in the costs for fuel oil, purchased energy and gas. The balances of these accounts represent amounts that will be recovered from, or repaid to, customers by adjustments to future rates. The CPUC reviews the reasonableness of the amounts in these accounts.

The CPUC has also ordered the use of a balancing account to record the ownership costs for San Onofre nuclear units 2 and 3 until the issue discussed in Note 6 is resolved.

Other

Certain prior year amounts have been reclassified for comparability.

See Note 4 regarding employee benefit plans, Note 5 regarding accounting for income taxes and Note 7 regarding accounting for leases.

2 Long-Term Debt

Combined aggregate maturities and sinking fund requirements of long-term debt are \$18 million for 1986, \$50 million for 1987, \$20 million for 1988, \$1 million for 1989 and \$30 million for 1990.

First mortgage bonds are secured by a lien on substantially all utility plant. Additional first mortgage bonds may be issued upon compliance with the provisions of the bond indenture.

Certain first mortgage bonds have variable interest rate provisions. Bondholders may elect to redeem their bonds at the interest adjustment dates. The next interest rate adjustment dates will be August 1, 1986 for the Series FF bonds, September 1, 1986 for the Series CC bonds and September 1, 1988 for the Series DD bonds.

Schedules of Financial Information by Segments of Business

(In Thousands of Dollars)

At December 31 or for the Years Then Ended	1985	1984	1983
Operating Revenues			
Unaffiliated customers			
Electric operations	\$1,395,655	\$1,292,839	\$1,207,078
Gas operations	304,729	280,379	283,553
Total	1,700,384	1,573,218	1,490,631
Intersegment transfers			
Gas operations*	207,929	251,631	204,673
Adjustments and eliminations	(169,611)	(204,148)	(165,097)
Total	38,318	47,483	39,576
Total operating revenues			
Electric operations	1,395,655	1,292,839	1,207,078
Gas operations	512,658	532,010	488,226
Adjustments and eliminations	(169,611)	(204,148)	(165,097)
Total	\$1,738,702	\$1,620,701	\$1,530,207
Operating Income			
Electric operations	\$ 261,199	\$ 224,156	\$ 149,082
Gas operations	26,668	27,394	25,073
Total	\$ 287,867	\$ 251,550	\$ 174,155
Depreciation and Amortization			
Electric operations	\$ 117,948	\$ 101,805	\$ 68,377
Gas operations	14,558	13,395	10,903
Total	\$ 132,506	\$ 115,200	\$ 79,280
Utility Plant Additions**			
Electric operations	\$ 205,469	\$ 174,753	\$ 273,436
Gas operations	35,750	23,022	18,563
Total	\$ 241,219	\$ 197,775	\$ 291,999
Identifiable Assets			
Utility plant—net			
Electric operations	\$2,303,025	\$2,197,292	\$2,142,303
Gas operations	218,618	195,736	185,928
Total	2,521,643	2,393,028	2,328,231
Materials and supplies			
Electric operations	37,614	39,580	27,017
Gas operations	3,722	3,745	3,137
Total	41,336	43,325	30,154
Fuel inventory			
Electric operations	30,391	40,606	74,027
Gas operations	259	1,035	2,061
Total	30,650	41,641	76,088
Other identifiable assets			
Electric operations	204,098	218,683	255,339
Gas operations	31,809	25,349	72,205
Total	235,907	244,032	327,544
Other Assets	256,426	228,669	78,178
Total Assets	\$3,085,962	\$2,950,695	\$2,840,195

* Revenue from interdepartmental transfers of gas allowed by the CPUC in tariff rates.

**Excluding allowance for funds used during construction.

See notes to financial statements.

The company is an operating public utility engaged principally in the generation, purchase, distribution and sale of electrical energy and the purchase, distribution and sale of natural gas. Income taxes and corporate expenses are allocated to departments in accordance with regulatory accounting requirements.

Statements of Long-Term Debt

(In Thousands of Dollars)

Balance at December 31	1985	1984
First mortgage bonds (Note 2)		
3¼% Series F, due October 1, 1985	\$ —	\$ 18,000
4⅞% Series G, due October 1, 1987	12,000	12,000
4⅝% Series H, due October 1, 1990	30,000	30,000
5½% Series I, due March 1, 1997	25,000	25,000
7% Series J, due December 1, 1998	35,000	35,000
8¾% Series K, due February 1, 2000	40,000	40,000
8% Series L, due September 1, 2001	45,000	45,000
8⅜% Series M, due January 15, 2004	75,000	75,000
10% Series P, due July 15, 2006	45,000	45,000
8¾% Series Q, due March 15, 2007	50,000	50,000
9¾% Series R, due May 1, 2008	50,000	50,000
16% Series S, due March 15, 2010	—	13,163
13⅞% Series T, due August 1, 2010	—	75,000
5½% Series U-2, due September 1, 1994	11,668	12,068
17⅞% Series V, due July 15, 2011	16,714	16,714
16.70% Series W, due November 3, 1987 and 1988	40,000	40,000
16.65% Series X, due September 1, 1986 and 1987	20,000	20,000
16.65% Series Y, due September 1, 1986 and 1987	15,000	15,000
12⅞% Series Z, due July 15, 2013	39,769	65,000
10% Series AA, due June 1, 2018	150,000	150,000
10% Series BB, due September 1, 2018	150,000	150,000
5.8% Series CC, due May 1, 2008	53,000	53,000
8.50% Series DD, due December 1, 2008	27,000	27,000
9¼% Series EE, due September 1, 2020	100,000	—
5.625% Series FF, due December 1, 2007	35,000	—
Total	1,065,151	1,061,945
Other long-term debt		
Foreign term loans	—	35,000
Pollution control bonds, 6⅜% 1977 Series A, due April 1, 2007	9,575	9,575
Pollution control bonds, 7.20% 1979 Series A, due April 1, 2009	5,700	5,700
Sinking fund debentures, 4½%, due September 1, 1994	1,412	1,441
Other	7,256	7,782
Total	23,943	59,498
Unamortized discount on long-term debt	(16,047)	(15,093)
Long-term debt redeemable within one year (Note 2)	(88,000)	(53,000)
Current portion of long-term debt (Note 2)	(17,980)	(18,560)
Total	\$ 967,067	\$1,034,790

See notes to financial statements.

Statements of Capital Stock

(In Thousands of Dollars Except Voluntary Redemption Price)

Balance at December 31	1985	1984
Common Equity		
Common stock, \$5 par value, authorized 80,000,000 shares, outstanding: 1985, 55,822,762 shares; 1984, 54,063,592 shares	\$ 279,114	\$ 270,318
Premium on capital stock	481,238	446,964
Retained earnings	392,632	335,623
Total common equity	\$1,152,984	\$1,052,905
Preferred Stock		
Not subject to mandatory redemption	Voluntary Redemption Price	
\$20 par value, authorized 1,375,000 shares		
5% Series, 375,000 shares outstanding	\$ 24.00	\$ 7,500
4½% Series, 300,000 shares outstanding	21.20	6,000
4.40% Series, 325,000 shares outstanding	21.00	6,500
4.60% Series, 375,000 shares outstanding	20.25	7,500
Without par value*		
\$9.84 Series, 160,000 shares outstanding	101.00	16,000
\$7.80 Series, 200,000 shares outstanding	103.00	20,000
\$7.20 Series, 150,000 shares outstanding	102.50	15,000
\$2.68 Series, 1,000,000 shares outstanding	29.25	25,000
\$2.475 Series, 1,000,000 shares outstanding	29.15	25,000
\$4.65 Series, 1,300,000 shares outstanding	32.15	32,500
Total not subject to mandatory redemption		\$161,000
Subject to mandatory redemption		
Without par value*		
\$8.25 Series, 1985, 115,000 shares; 1984, 125,000 shares outstanding	105.225	\$ 11,500
\$9.125 Series, 1985, 240,000 shares; 1984, 260,000 shares outstanding	113.50	24,000
\$15.44 Series, 250,000 shares outstanding	115.44	25,000
Current sinking fund requirement		(3,000)
Total subject to mandatory redemption		\$ 60,500

*Authorized 10,000,000 shares total (both subject to and not subject to mandatory redemption).
See notes to financial statements.

Statements of Changes in Capital Stock and Retained Earnings

(In Thousands of Dollars)

For the Years Ended December 31, 1983, 1984 and 1985	Preferred Stock		Common Stock	Premium on Capital Stock	Retained Earnings
	Not Subject to Mandatory Redemption	Subject to Mandatory Redemption			
Balance, December 31, 1982	\$161,000	\$108,000	\$241,331	\$353,226	\$222,884
Net income					187,370
Common stock sold (3,427,518 shares)			17,137	47,652	
Preference stock retired (425,000 shares)		(42,500)		12,537	
Current sinking fund requirement		(2,000)		12	
Dividends declared					
Preferred stock					(27,441)
Common stock					(97,101)
Balance, December 31, 1983	161,000	63,500	258,468	413,427	285,712
Net income					183,467
Common stock sold (2,369,930 shares)			11,850	33,537	
Current sinking fund requirement		(3,000)			
Dividends declared					
Preferred stock					(24,030)
Common stock					(109,526)
Balance, December 31, 1984	161,000	60,500	270,318	446,964	335,623
Net income					202,722
Common stock sold (1,759,170 shares)			8,796	34,274	
Current sinking fund requirement		(3,000)			
Dividends declared					
Preferred stock					(23,785)
Common stock					(121,928)
Balance, December 31, 1985	\$161,000	\$ 57,500	\$279,114	\$481,238	\$392,632

See notes to financial statements.

Statements of Sources of Funds for Construction

(In Thousands of Dollars)

For the Years Ended December 31	1985	1984	1983
Funds Provided by Operations			
Net income	\$202,722	\$183,467	\$187,370
Non-cash items in net income			
Depreciation and amortization	132,506	115,200	79,280
Deferred income taxes and investment tax credits-net	69,829	90,922	85,728
Allowance for funds used during construction a	(8,072)	(23,343)	(78,110)
Gain on sale of subsidiary b	—	—	(14,533)
Other-net	2,468	4,609	7,694
Funds provided by operations c	399,453	370,855	267,429
Dividends	(145,713)	(133,556)	(124,542)
Funds reinvested	253,740	237,299	142,887
Funds Provided (Used) by Long-Term Financing			
Sale of common stock	43,070	45,387	64,789
Sale of first mortgage bonds d	131,227	77,757	288,177
Retirement of long-term financing d	(183,187)	(53,725)	(17,124)
Retirement of preference stock	—	—	(29,963)
Refunding of long-term financing			
Issued	—	—	63,262
Refunded	—	—	(70,023)
Call premium	—	—	(14,853)
Funds provided (used) by long-term financing	(8,890)	69,419	284,265
Other Funds Provided (Used)			
Regulatory balancing accounts-net	27,500	(1,144)	10,327
Investments and other property	(5,215)	(7,635)	1,067
Construction funds held by trustee	(25,448)	131,290	(154,780)
Cash and temporary investments	(5,183)	(142,171)	(3,387)
Receivables	1,806	(3,293)	(10,450)
Fuel inventory	10,991	34,447	35,851
Short-term borrowings	—	(85,000)	(91,000)
Accounts payable	26,222	(47,708)	33,611
Taxes accrued	(7,190)	54	11,134
Other-net	(27,114)	12,217	32,474
Other funds provided (used)	(3,631)	(108,943)	(135,153)
Total additions to utility plant (excluding allowance for funds used during construction)	\$241,219	\$197,775	\$291,999

Excerpts from the Financial Review

a. The quality of earnings improved in 1985 as the allowance for funds used during construction declined to five percent of earnings compared to fifteen percent of earnings the prior year.

b. In 1983, the gain came from the sale of a cogeneration subsidiary to Energy Factors, Inc.

c. The company again met its goal of financing more than 65 percent of its utility plant additions through operations.

d. Tax-exempt financings, backed by SDG&E first mortgage bonds, plus retirement of long-term financings, helped reduce gross interest charges in 1985.

See notes to financial statements.

Balance Sheets

(In Thousands of Dollars)

Balance at December 31	1985	1984	Excerpts from the Financial Review
Assets			
Utility plant—at original cost			
In service			
Electric	\$2,790,158	\$2,661,219	
Gas	347,317	319,025	
Common	46,743	36,646	
Total plant in service	3,184,218	3,016,890	
Plant held for future use	1,009	1,157	
Construction work in progress	117,336	52,910	
Total utility plant	3,302,563	3,070,957	
Accumulated depreciation	(780,920)	(677,929)	
Utility plant—net (Note 2)	2,521,643	2,393,028	
Investments and other property	57,953	53,499	
Construction funds held by trustee (Note 7)	48,938	23,490	
Current assets			
Cash and temporary investments	152,231	147,048	
Receivables (less allowance for doubtful accounts: 1985, \$1,311; 1984, \$1,218)			
Customer	122,661	123,276	
Other	12,173	13,364	
Materials and supplies—at average cost	41,336	43,325	
Fuel inventory—at average cost	30,650	41,641	
Regulatory balancing accounts undercollected—net	—	22,466	
Other	7,180	2,644	
Total current assets	366,231	393,764	
Deferred charges and other assets	91,197	86,914	
Total	\$3,085,962	\$2,950,695	
Capitalization and Liabilities			
Capitalization (see Statements of Capital Stock and Long-Term Debt)			
Common equity	\$1,152,984	\$1,052,905	
Preferred stock			
Not subject to mandatory redemption	161,000	161,000	
Subject to mandatory redemption	57,500	60,500	
Long-term debt (Note 2)	967,067	1,034,790	
Total capitalization	2,338,551	2,309,195	
Current Liabilities			
Long-term debt redeemable within one year (Note 2)	88,000	53,000	
Current portion of long-term debt (Note 2)	17,980	18,560	
Accounts payable	138,145	111,923	
Dividends payable	37,183	34,366	
Taxes accrued	27,011	34,201	
Interest accrued	29,813	33,439	
Regulatory balancing accounts overcollected—net	5,034	—	
Other	56,528	62,518	
Total current liabilities	399,694	348,007	
Customer advances for construction	52,006	44,903	
Accumulated deferred income taxes—net (Note 5)	107,941	67,411	
Accumulated deferred investment tax credits (Note 5)	153,980	148,191	
Deferred credits	33,790	32,988	
Contingencies and commitments (Notes 6 and 7)	—	—	
Total	\$3,085,962	\$2,950,695	

a. Construction expenditures in 1985 remained below the limit of 10 percent of capitalization that the company has set as an annual goal. The goal has again been met even though approximately \$240 million was spent on upgrading and extending facilities.

b. Increases in common equity from net income and sales of common stock exceeded dividend payments and preferred stock retirements by \$97 million in 1985.

c. Reductions in long-term debt helped improve the capital structure in 1985. The company's goal is to limit long-term debt to 44 to 46 percent of its capitalization.

See notes to financial statements.

Statements of Income

(In Thousands Except Per Share Amounts)

For the Years Ended December 31	1985	1984	1983
Operating Revenues			
Electric	\$1,395,655	\$1,292,839	\$1,207,078
Gas	343,047	327,862	323,129
Total operating revenues	1,738,702	1,620,701	1,530,207
Operating Expenses			
Electric fuel and purchased power a	535,968	521,621	622,422
Gas purchased for resale b	223,407	213,813	209,912
Transmission, distribution and storage	40,263	43,725	43,658
Franchise payments	34,443	30,961	30,586
Other operating c	182,867	190,359	164,714
Maintenance d	74,484	73,164	59,595
Depreciation and amortization d	132,506	115,200	79,280
Property and other taxes d	35,179	32,088	21,420
Income taxes (Note 5)	191,718	148,220	124,465
Total operating expenses	1,450,835	1,369,151	1,356,052
Operating Income	287,867	251,550	174,155
Other Income and (Deductions)			
Allowance for other funds used during construction	5,772	19,241	55,904
Taxes on nonoperating income (Note 5)	(972)	10,656	25,137
Other—net	23,269	9,296	17,755
Total other income	28,069	39,193	98,796
Income Before Interest Charges	315,936	290,743	272,951
Interest Charges			
Long-term debt	104,449	100,391	86,268
Short-term debt and other	11,065	10,987	21,519
Allowance for borrowed funds used during construction	(2,300)	(4,102)	(22,206)
Net interest charges	113,214	107,276	85,581
Net Income (before preferred dividend requirements)	202,722	183,467	187,370
Preferred Dividend Requirements	23,797	24,172	27,449
Earnings Applicable to Common Shares	\$ 178,925	\$ 159,295	\$ 159,921
Average Common Shares Outstanding	55,125	52,868	49,994
Earnings Per Common Share	\$ 3.25	\$ 3.01	\$ 3.20
Dividends Declared Per Common Share	\$ 2.205	\$ 2.065	\$ 1.925

Excerpts from the Financial Review

a. The cost of electric fuel and purchased power was up three percent in 1985. This was due to increased sales volume, less lower unit costs.

b. The cost of gas increased in 1985 because of higher volume; but lower gas prices kept this increase from being greater.

c. This was the first decrease in other operating costs in more than 20 years, despite the effects of system growth and inflation.

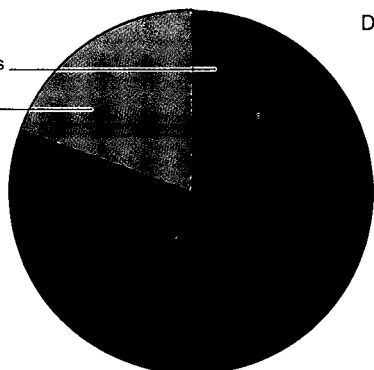
d. Maintenance expense, depreciation and property taxes increased because of the addition of the Southwest Powerlink and commercial operation of San Onofre Nuclear Generating Station units 2 and 3.

See notes to financial statements.

1985 Revenue Dollar

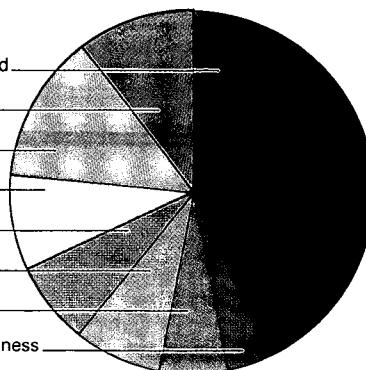
Source

80.3¢ Electric Sales
19.7¢ Gas Sales



Disposition

43.7¢ Fuel and Purchased Power
10.3¢ Other Operating Expenses
13.1¢ Total Taxes
8.4¢ Dividends to Shareholders
7.6¢ Depreciation
7.4¢ Salaries and Benefits
6.2¢ Cost of Money—net of AFUDC
3.3¢ Reinvested in Business



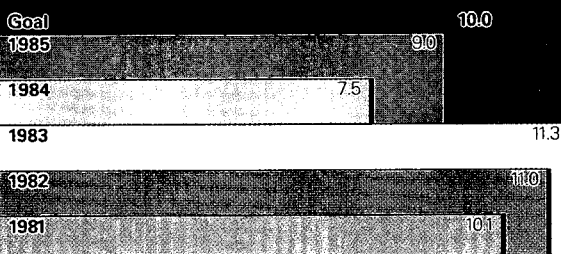
In 1985, 43.7 cents of every revenue dollar went toward the purchase of fuel and purchased energy. Just five years ago, this figure was 63.8 cents.

Financial Review

cash flow and also reduces the ultimate rates charged the consumer by avoiding an interim interest cost that would ultimately have been included in rates to the extent the costs are approved.

Construction: The company manages the level of its construction activity. The company's program to avoid building any new central generating plants has enabled it to achieve its goal of limiting construction expenditures to a maximum of 10 percent of capitalization.

Limit Construction Expenditures to 10 Percent of Capitalization

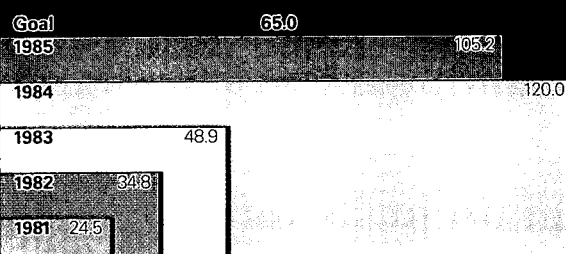


(construction expenditures exclude AFUDC)
(capitalization includes capital leases and short-term debt)

This goal has again been met even though approximately \$240 million is being spent annually on upgrading and extending facilities to meet the population growth in the company's service area and the increase in commercial and industrial activity. The primary method of minimizing construction expenditures has been to increase the percentage of power that the company purchases from others. This reduces the cost of energy, since power can be purchased from other areas of the country for less than the company's cost of increasing its generating capacity.

The above techniques have enabled the company to continue to show strong liquidity, as shown primarily by the increase in the percentage of new construction financed by operations in 1985 and 1984 compared to 1983 and prior years.

Increase Internal Generation of Construction Expenditures (to 65 percent or more)



(construction expenditures exclude AFUDC) (by percent)

Outlook: Continued improvement in internal financing of construction is largely dependent upon the

Southwest Powerlink balancing account described in Note 7 to the financial statements and the outcome of the commission's review of the reasonableness of the construction costs of San Onofre Nuclear Generating Station units 2 and 3. The commission staff has proposed substantial disallowance of costs associated with the units. The company and Southern California Edison are vigorously contesting the staff's position and a decision is not expected until late 1986. The outcome cannot be predicted at this time; however, if a significant portion of the proposed disallowances are adopted, there would be a material adverse impact on the company's net income and a lesser impact on cash flow.

The company's liquidity is also significantly affected by normal ratesetting activities. Beginning with 1986, the commission will hear a General Rate Case every third year, instead of every second year. Rates for the intervening two years will be handled by an attrition allowance, whereby rates are adjusted to reflect changes in expenses and certain financing costs caused by factors such as growth and inflation. The fuel cost component of rates is excluded from the General Rate Case procedure and is based on the company's actual cost of fuel.

In 1985 and 1984, the company reduced its debt by \$33 million and \$57 million, respectively. In 1986, further reductions of approximately \$35 million are anticipated. In 1987, if the final resolution of the commission review of San Onofre includes a significant disallowance, further debt reductions may be smaller.

Capital structure: Increases in common equity from net income and sales of common stock (all related to the Savings Plan and Common Stock Investment Plan) exceeded dividend payments and preferred stock retirements by \$97 million in 1985 and \$92 million in 1984. This and the reductions in long-term debt resulted in the company's capital structure progressing toward its stated goal as follows:

	1981	1982	1983	1984	1985	Goal
Common equity	32%	36%	37%	40%	43%	45-48%
Preferred stock	12	12	9	9	8	7-10
Debt and leases	56	52	54	51	49	44-46

Additional liquidity is provided by the company's \$60 million line of credit—which the company has not used since June 1984 except for a three-day period in February 1985.

Future changes in capital structure are dependent upon the final outcome of the Southwest Powerlink and San Onofre reviews and the details of the company's diversification program.

Results of Operations

The company's net income increased \$19 million in 1985, a 10 percent increase over 1984. This was due to increased revenues and decreases in various costs.

Revenue

Electric Operations: Increases in electric revenues were due to changes in the following:

(Millions of Dollars)

For the Years Ended December 31	1985	1984
General rates	\$132.6	\$146.7
Fuel cost rates	(26.7)	(171.2)
Regulatory balancing accounts:		
San Onofre units 2 and 3	(86.8)	65.5
Fuel cost	36.0	(35.5)
Other	(2.2)	9.2
Sales volume and other	49.9	71.1
Net increases	\$102.8	\$ 85.8

Refer to Notes 1 and 6 to the financial statements for discussion of San Onofre units 2 and 3.

Gas Operations: Increases in gas revenues were due to changes in the following:

(Millions of Dollars)

For the Years Ended December 31	1985	1984
Rates	\$(51.0)	\$16.0
Regulatory balancing accounts:		
Consolidated adjustment mechanism	25.0	(23.8)
Other	(1.0)	(1.5)
Interdepartmental transfers	(9.2)	7.9
Sales volume and other	51.4	6.1
Net increases	\$ 15.2	\$ 4.7

Costs

The cost of electric fuel and purchased power increased in 1985 because increases in sales volume exceeded decreases in costs per kilowatt-hour. In 1984 the decrease in cost per kilowatt-hour exceeded the increase in sales volume. Costs per kilowatt-hour decreased in both years because of changes in fuel mix and reductions in fuel prices.

The cost of gas increased because increases in volume (13 percent in 1985 and 6 percent in 1984) exceeded decreases in the price of gas.

Other operating costs decreased by \$7.5 million (4 percent) in 1985, the first decrease in over twenty years, despite the effects of system growth and inflation. This reversed the upward trend that in 1984 included the effects of the Southwest Powerlink, the Heber Binary Project and commercial operation of San Onofre units 2 and 3.

Maintenance expense, depreciation and property taxes increased in 1985 and 1984 due to the addition

of the facilities discussed above and growth in the number of customers.

Taxes on operating income increased in 1985 and 1984 due to increased operating income, partly offset in 1984 by a lower effective tax rate.

The total allowance for construction funds (both debt and equity) decreased in 1985 and 1984 due to completion in 1984 of the major construction projects discussed above.

Other income—net increased in 1985 due to an increase in temporary investments. Other income was higher in 1983 than in 1984 due primarily to the gain from the sale of a subsidiary.

Interest charges shown on the Statements of Income on page 19 are net of interest income on construction funds temporarily invested by the trustee. These interest charges increased in 1984 due to new issuances of long-term debt. They increased again in 1985 because the decline in construction funds more than offset the reduction in interest expense from mandatory and voluntary redemptions of long-term debt and the use of lower rate tax-exempt financings. The company's embedded cost of debt decreased from 10.5 percent in 1983 and 1984 to 10.1 percent in 1985, enabling the company to surpass its goal of achieving 3.75 times pretax interest coverage. The company's embedded cost of debt is expected to continue to decline.

Quality of Earnings

The 1985 increase in net income was particularly significant in that it occurred despite a decline in allowance for funds used during construction from 15 percent of earnings in 1984 to 5 percent in 1985. Earnings applicable to common shares, excluding the allowance for funds used during construction, increased from \$136 million in 1984 to \$171 million in 1985.

Liquidity and Capital Resources

In 1985, the company again increased its liquidity.

The liquidity of a utility is greatly impacted by rate-setting and construction activity. Thus, the company exerts every effort to influence these factors. For the company, rates are established by the California Public Utilities Commission and construction activity is affected by population and industrial growth in the service area, per capita energy usage and the quantity and price of the various energy sources.

These external factors are critical to the company. There are methods to mitigate them when they are harmful or magnify them when they are beneficial.

Ratesetting: The commission permits the company to include disputed costs in its rates while the company and the commission are still resolving the ultimate treatment of the costs. This improves the company's

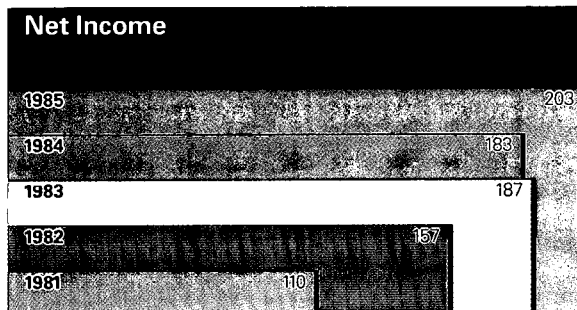
Financial Review

(In Thousands of Dollars Except Per Share Amounts)

For the Years Ended December 31	1985	1984	1983	1982	1981
Operating revenues	\$1,738,702	\$1,620,701	\$1,530,207	\$1,430,948	\$1,159,662
Operating income	287,867	251,550	174,155	169,861	142,123
Net income (before preferred dividend requirements)	202,722	183,467	187,370	157,303	110,156
Earnings per common share	3.25	3.01	3.20	2.90	2.34
Dividends declared per common share	2.205	2.065	1.925	1.785	1.64
Funds provided by operations	399,453	370,855	267,429	196,084	135,131
Funds provided (used) by long-term financing	(8,890)	69,419	284,265	141,173	138,455
Additions to utility plant (excluding allowance for funds used during construction)	241,219	197,775	291,999	252,790	209,729
At December 31					
Total assets	3,085,962	2,950,695	2,840,195	2,411,676	2,160,254
Long-term debt and preferred stock subject to mandatory redemption (excludes current portion)	1,112,567	1,148,290	1,099,903	893,043	812,238

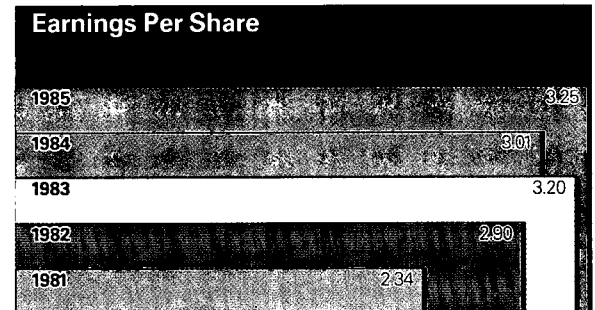
The Financial Review should be read in conjunction with the financial statements, notes to financial statements and statistical data contained elsewhere in this report.

After a slight dip in 1984, net earnings turned upward again in 1985.



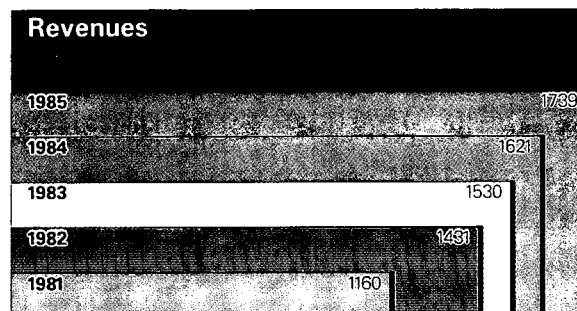
(in millions of dollars)

Earnings in 1985 were \$3.25 per share—the highest ever for the company.



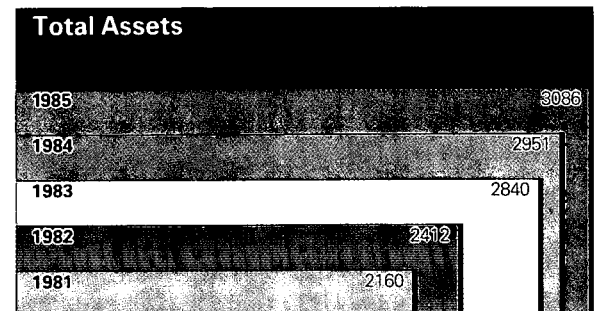
(in dollars)

Revenues for the year 1985 increased seven percent, surpassing \$1.7 billion.



(in millions of dollars)

For the first time in the year-end history of the company, assets exceeded \$3 billion.



(in millions of dollars)



San Diego's pleasant year-round climate is attracting many people, some of whom are choosing to live downtown. Since everyone is a customer, the high rate of growth is providing both challenges and opportunities for SDG&E.

The San Diego Trolley has proved so popular during its five years of operation between downtown and the international border to the south that a second line is being built to serve eastern communities. SDG&E is involved with many aspects of this light rail system. During construction of the lines, the company coordinates the relocation of its gas and electric lines. When the lines are completed, SDG&E provides the electricity that operates the trolleys and the system's ticket fare machines.

