



Southern California Edison Company

1986 Annual Report

1886 Southern California Edison Company celebrated its centennial in 1986. Although the Company was incorporated in 1909, its beginnings can be traced to 1886 when predecessor companies first supplied electricity to portions of Central and Southern California. During the first 100 years, Edison's record of innovation, technological achievements, environmental protection, customer service and financial stewardship to shareholders is a testament to the efforts of Edison people, past and present, working together with great dedication, creativity and courage. They have never lost sight of our early operating principle—Good Service, Square Dealing, Courteous Treatment. As we enter our second century of service, we look at the past with pride, but more importantly, to the future with optimism.

1986

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Highlights

	1986	1985	Percent Change	Five-Year Compound Annual Growth Rate
Operating Revenues (000)	\$5,311,733	\$5,168,848	2.8%	5.6%
Fuel and Purchased Power Costs (000)	\$1,653,854	\$2,389,087	(30.8)	(8.4)
Earnings Available for Common and Original Preferred Stock (000)	\$713,933	\$702,409	1.6	11.1
Weighted Average Shares of Common and Original Preferred Stock (000)	217,732	215,649	1.0	4.9
Earnings Per Share	\$3.28	\$3.26	0.6	5.9
Dividends Paid Per Common Share	\$2.22	\$2.10	5.7	7.9
Market Price Per Common Share—Year End	\$33 ⁷ / ₈	\$26 ⁵ / ₈	27.2	18.7
Book Value Per Common Share	\$22.02	\$21.04	4.7	5.5
Total Assets (000)	\$13,244,952	\$12,593,449	5.2	8.8
Funds Used for Construction Expenditures (000)	\$1,089,677	\$1,076,495	1.2	2.6
Kilowatt-Hour Sales (000)	64,197,405	64,984,566	(1.2)	0.6
Number of Customers	3,589,414	3,490,325	2.8	2.1
Number of Employees	17,553	17,182	2.2	3.8
Area Generating Capacity at Peak (Megawatts)	18,320	17,776	3.1	3.3

Earnings Per Share and Annual Dividend Rate

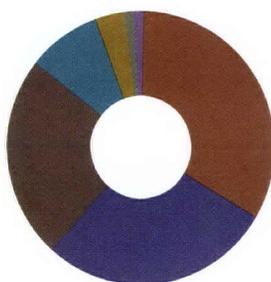


The Company's 1986 earnings per share reached an all-time high of \$3.28, the sixth consecutive year of record earnings. A 5.6% increase in the common stock quarterly dividend raised the annual dividend rate to \$2.28 per share.

Sources and Distribution of Revenues

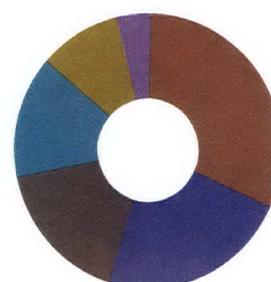
Sources

- 34% Commercial
- 28% Residential
- 23% Industrial
- 9% Public Authorities
- 4% Resale
- 1% Agriculture
- 1% Other



Distribution

- 32% Fuel and Purchased Power
- 23% Operation and Maintenance
- 17% Dividends and Interest
- 14% Taxes and Other
- 10% Depreciation
- 4% Reinvested Earnings



The Company's 1986 sources of revenue reflect a fairly balanced contribution from the three major customer classes—commercial, residential and industrial. Fuel and purchased power costs continued to represent a major portion of the distribution of revenues.

The Year at a Glance

Earnings per share of common stock increased moderately over the 1985 level to an all-time high of \$3.28, the sixth consecutive year of record earnings.

The common stock dividend was increased in June by 5.6 percent to \$2.28 a year, the 11th increase in the past 10 years.

The market price of common stock reached a record high of \$38³/₄ in August and closed the year at \$33⁷/₈, 27 percent higher than year-end 1985.

Total return to common stock shareholders from stock appreciation and dividends was almost 36 percent; total return over the past five years has averaged 28.5 percent annually.

Customers increased by nearly 100,000, the largest increase in 20 years, and sales to customers within the Company's service territory rose 1.9 percent. However, total kilowatt-hour sales declined 1.2 percent, largely because sales to other utilities declined, and some of Edison's municipal resale customers obtained more of their power from outside the Edison system.

Four non-utility subsidiaries were established to take advantage of business opportunities in areas other than the regulated utility business.

The California Public Utilities Commission (CPUC) disallowed \$258.6 million of \$3.4 billion of the Company's construction costs for San Onofre Nuclear Generating Station Units 2 and 3. The Company has filed for a rehearing on \$213.4 million of the disallowance.

The CPUC and Edison agreed to rate and rate-base treatment for the Company's 15.8 percent interest in the Palo Verde Nuclear Generating Station in Arizona. The agreement, which avoided a lengthy prudence review, phases rates in over 10 years and ties the amount of Edison's investment in Palo Verde that will be put in the rate base to the outcome of the San Onofre prudence review. Based on the current CPUC decision, the disallowance for Edison's \$1.5 billion investment in Palo Verde will total \$50 million.

Authorized return on common equity was reduced by the CPUC from 16 percent to 14.6 percent in 1986 and to 13.9 percent in 1987 because of lower levels of inflation and lower interest rates.

Edison issued a record \$1.7 billion of debt, all of which was used to refinance higher-cost securities. This brought total refinancings of higher-cost securities to \$2.7 billion since 1984, which will save customers more than \$70 million annually.

Fuel and purchased power costs declined 31 percent—primarily because of lower oil and natural gas prices—from \$2.39 billion in 1985 to \$1.65 billion in 1986, which is reflected in lower costs to customers.

Enactment of the Electric Consumers Protection Act of 1986 ensured fairness in federal relicensing of hydroelectric plants. The new law makes clear that no preference exists favoring municipal utilities over investor-owned utilities when low-cost hydroelectric facilities are relicensed.

Fellow Shareholders:

In 1986, we celebrated our corporate centennial with the best financial performance in the Company's history. We recorded our sixth consecutive year of record earnings and our 11th dividend increase in the past 10 years. Our common stock price reached an all-time high, and total return to our shareholders from stock appreciation and dividends was almost 36 percent. Today, we are one of the nation's largest and most financially sound investor-owned electric utilities.

Our 50,000 square-mile service territory, if a separate nation, would have the 14th largest economy of any country in the world. Future economic growth could make our service territory the equivalent of the 10th largest economy in the world by the turn of the century.

Serving well the people who work and live in our service territory presents a continuing challenge. We are proud of the record we have established in our first century of service, and we are confident of the future as we enter our second century of "Good Service, Square Dealing, Courteous Treatment."

Changes in Business Environment

The environment in which we do business as a regulated electric utility has changed substantially in the last few years. An unanticipated effect of federal legislation and state implementing regulations, designed to cope with the energy crisis in the 1970s, has been the emergence of unregulated power producers from whom we are required to purchase power at prices often higher than it costs us to generate it or purchase it elsewhere. The result has been an unfair cost burden on our customers. We are working with regulatory authorities and the non-regulated producers to reduce this impact on our customers.

We also are seeking to restructure rates. The California Public Utilities Commission (CPUC), for various public policy reasons, over the years has set industrial rates higher than the cost of providing service to industrial customers. In some cases this has made it economically attractive for industrial customers to generate their own electricity and bypass the Edison system. If these customers bypass the utility system, the result would be more expensive electrical service for the remaining customers because the fixed costs of service would be spread across a smaller base. Our Company is taking a number of steps to try to correct this inequitable situation and to continue serving these large industrial customers so they will pay their fair share of the cost of providing electric service to all our customers.

At the same time, we are working closely with large commercial and industrial customers to innovatively meet their particular needs. We also are increasing employee productivity and focusing, to an even greater extent than previously, on cost-control programs.

Another matter involves efforts by some non-regulated power producers to obtain unlimited use of our transmission lines in order to sell their power wherever and whenever they want. This is known as "mandatory wheeling" and would increase costs to all but a few of our customers and reduce electric system reliability for all our customers. We are opposing such efforts nationally and in California.

Southern California Edison remains dedicated to its primary mission as a regulated electric utility. We are, however, also ready to proceed in an unregulated environment if public policy makers change the rules under which we do business. Last year we established new non-utility subsidiaries to develop business opportunities in several unregulated markets. One of them, Mission En-

ergy Company, is a co-owner and operator of several cogeneration and alternative energy projects in California and Nevada. Two other subsidiaries are engaged, respectively, in industrial park development, and in engineering and construction of electrical facilities; another will specialize in financial services.

Regulatory and Legislative Matters

The only major disappointment for the Company during the year was a regulatory decision in late 1986. The CPUC, following a four-year prudency review, by a 3-to-2 vote disallowed \$258.6 million, or 7.6 percent, of \$3.4 billion of Edison's investment in the San Onofre Nuclear Generating Station Units 2 and 3. This decision was directly contradictory to the findings of the CPUC Administrative Law Judge who heard all 95 days of public hearings and who recommended that no financial penalty be assessed against the construction costs of San Onofre Units 2 and 3. We have appealed to the CPUC for reconsideration of most of the disallowance, and a ruling on our petition for rehearing is expected in March.

The CPUC decision on San Onofre Units 2 and 3 also affects our \$1.5 billion investment in the three nuclear units at Palo Verde, Arizona. In 1986, Edison and the CPUC agreed that the Commission's decision on San Onofre Units 2 and 3 would be used as a basis for avoiding a protracted and costly prudency proceeding of Palo Verde involving four state regulatory agencies. The agreement established a disallowance level for Palo Verde amounting to 19 cents for each \$1 disallowed at San Onofre Units 2 and 3. Based on the CPUC decision as it currently stands, \$50 million, or 3.3 percent, of Edison's \$1.5 billion investment in Palo Verde would be disallowed.

The impact that the CPUC decision may have on earnings depends on the timing and outcome of

our appeal to the CPUC for rehearing and a possible appeal to the California Supreme Court. For a further discussion of the financial implications of this matter, please refer to the Financial Review section of this report on page 21 and in Note 2 of "Notes to the Financial Statements" on page 46.

We achieved a major legislative victory in 1986 when Congress passed, and the President signed, a bill protecting the rights of investor-owned utilities who own and operate federally licensed hydroelectric facilities. The new law should allow our customers to continue to enjoy the benefits of low-cost power from the hydro facilities that we have built over the past 50 years.

Our Second Century

We have learned much from our first century of service. One important lesson is that things seldom turn out the way experts predict. World energy markets, forecasts about future electricity demand, laws, regulations affecting our business, and many other factors are likely to change tomorrow in ways that are impossible to predict today. Recognizing this, we have developed strategies to cope with future changes by building considerable flexibility into our Company.

Our future resource plans provide clearly mapped paths into the future no matter how outside conditions change and regardless of how quickly or slowly demand grows. We are pursuing important new research efforts that will give us the technical ability to respond to more rapidly changing customer needs. Our strategy of starting to diversify into non-utility businesses gives us an opportunity for earnings growth independent of possible changes in regulation.

Our commitment to good customer service will continue as we enter our second century, for we are convinced that our shareholders and investors are best served if the needs of our customers are well met.

Management Changes

Reflecting our diversification efforts, two of our vice presidents resigned from the Company to become presidents of new Edison subsidiaries. Edward A. Myers, Jr., became president of Mission Energy Company, and Robert E. Umbaugh became president of Mission Land Company. Their responsibilities at the parent company were assumed by other officers as part of our program to increase productivity and control costs.

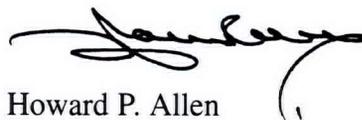
Two other officers retired in 1986. Joe T. Head, Jr., vice president of Power Supply, retired in September after 37 years of dedicated service. His responsibilities were assumed by Dr. L. T. Papay, senior vice president. Honor Muller, corporate secretary, retired at year end after 39 years of valued service.

In November, the Board of Directors elected Jennifer Moran, previously senior counsel in the Law Department, as corporate secretary, effective January 1, 1987.

Confidence for the Future

As we enter our second century of service, we stand at the threshold of a new era of change in our industry. We have positioned ourselves to take advantage of new opportunities and meet new challenges, while never forgetting that our main business is providing regulated electric utility service to the 10 million people who live and work in our service territory.

Our confidence in the future is strengthened by the proven dedication, abilities and hard work of our 17,500 employees, the prudent counsel of our Directors and the continued support of you, our shareholders.

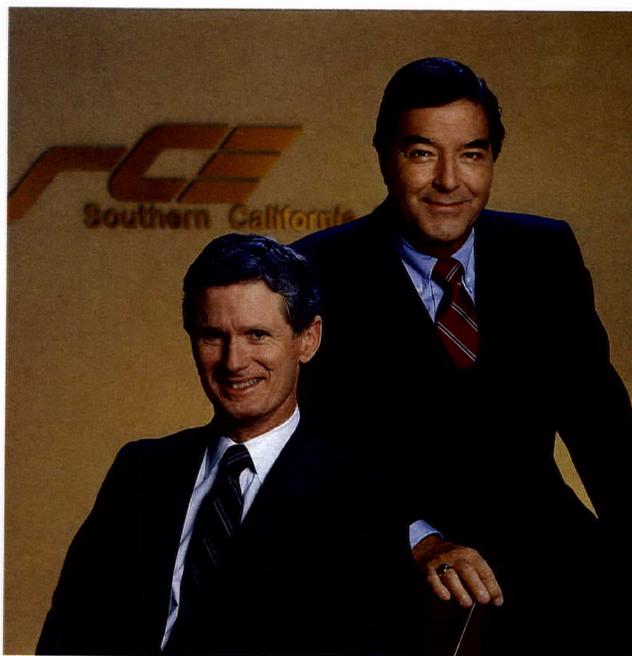


Howard P. Allen
*Chairman of the Board
and Chief Executive Officer*



H. Frederick Christie
President

February 19, 1987



H. Frederick Christie

Howard P. Allen



Good customer service demands a continuing search for new ways to respond to the specific needs of individual customers. Customer service specialists like Laura Estrada respond to more than five million calls annually from customers at the Company's modern, computerized Customer Telephone Information Centers. Edison implemented a new program during 1986 that included the hiring and training of part-time employees to handle calls, and

expansion of its bilingual services to communicate better with non-English-speaking customers.

Even before the use of modern communications technologies, Edison employees, as seen at the Long Beach office in 1908, were dedicated to the Company motto of "Good Service, Square Dealing, Courteous Treatment."



Year in Review

In 1986, Southern California Edison Company marked another year of excellence in financial performance and service to customers, and also increased its operating flexibility to meet the new challenges of a changing business environment and an uncertain world energy market.

Customer Growth and Energy Sales

Edison recorded strong growth during 1986 in the number of customers it serves throughout its 50,000 square-mile territory in Central and Southern California. The number of customers rose by 99,089, the largest increase in 20 years. There was continued growth in all sectors, particularly industrial, where the number of customers increased by 4.6 percent, the highest growth since 1977. Commercial and residential customer growth increased by 2.9 percent and 2.8 percent, respectively.

With this growth in the actual number of customers, the Company's 1986 sales to customers within its service territory grew 1.9 percent.

Total kilowatt-hour (KWH) sales, however, declined 1.2 percent from 65.0 billion KWH in 1985 to 64.2 billion KWH because of two major factors: (1) a drop in "spot market" sales to other utilities and (2) decreased energy purchases by Edison's six resale city customers, who obtained an increasing proportion of their power from non-Edison sources, including ownership interest by several in a Utah coal-fired generating station.

Other factors affecting 1986 electricity sales were mild summer temperatures that reduced air-conditioning use and an increased number of large industrial customers who developed their own self-generation and bypassed the Edison system.

Edison is working aggressively to avoid further loss of electricity sales to large customers. For example, the Company began offering industrial customers new discounts during 1986

on rates during off-peak periods. In addition, the Company has requested in its recently filed 1988 General Rate Case that the California Public Utilities Commission (CPUC) approve lower rates for industrial and commercial customers to reflect more closely the costs of providing them service. This proposed new rate structure, combined with new efforts to meet the specialized needs of large customers, should reduce future bypass of the Edison system.

Peak Demand

The peak customer demand for electricity in 1986 was 14,599 megawatts (MW) on August 20. On that day, the Company had an electric reserve margin of 25.5 percent. The 1986 peak was 0.1 percent above the 1985 high, but below the record peak of 15,189 MW set in 1984 during unusually hot summer weather.

Energy Management

The Company's energy management programs reduce peak demand by encouraging customers to shift their use of electricity from times of high use to periods of low use. Through 1986, these programs, which improve the utilization of existing generating resources, have reduced the need for nearly 1,300 MW in electric capacity during peak periods, roughly equivalent to the output of a large nuclear generating unit.

Kilowatt-Hour Sales

Class of Service	Kilowatt-Hour Sales			
	% of 1986 total	(In Millions)		% change
		1986	1985	
Commercial	31.4	20,145	19,111	5.4
Residential	29.2	18,767	18,583	1.0
Industrial	24.3	15,588	15,707	(0.8)
Public Authorities	7.9	5,078	4,885	3.9
Agricultural/Other	1.3	853	1,016	(16.0)
Retail Sales	94.1	60,431	59,302	1.9
Resale Cities	4.4	2,789	3,875	(28.0)
Sales to Other Utilities	1.5	977	1,808	(46.0)
Total	100.0	64,197	64,985	(1.2)

Customer Service

Over the last 100 years, the Company has recognized the vital importance of providing quality service to its customers. This service is constantly being measured and improved. An example of this commitment is a continuing search for new and more effective ways to respond to the specialized needs of individual customers.

To achieve this, Edison has established programs designed to make employees more sensitive to customer needs, including new training programs, screening of new employees for a "desire to serve," task forces dedicated to specific service quality and cost issues, recognition of employees providing exemplary service, and increased customer communication.

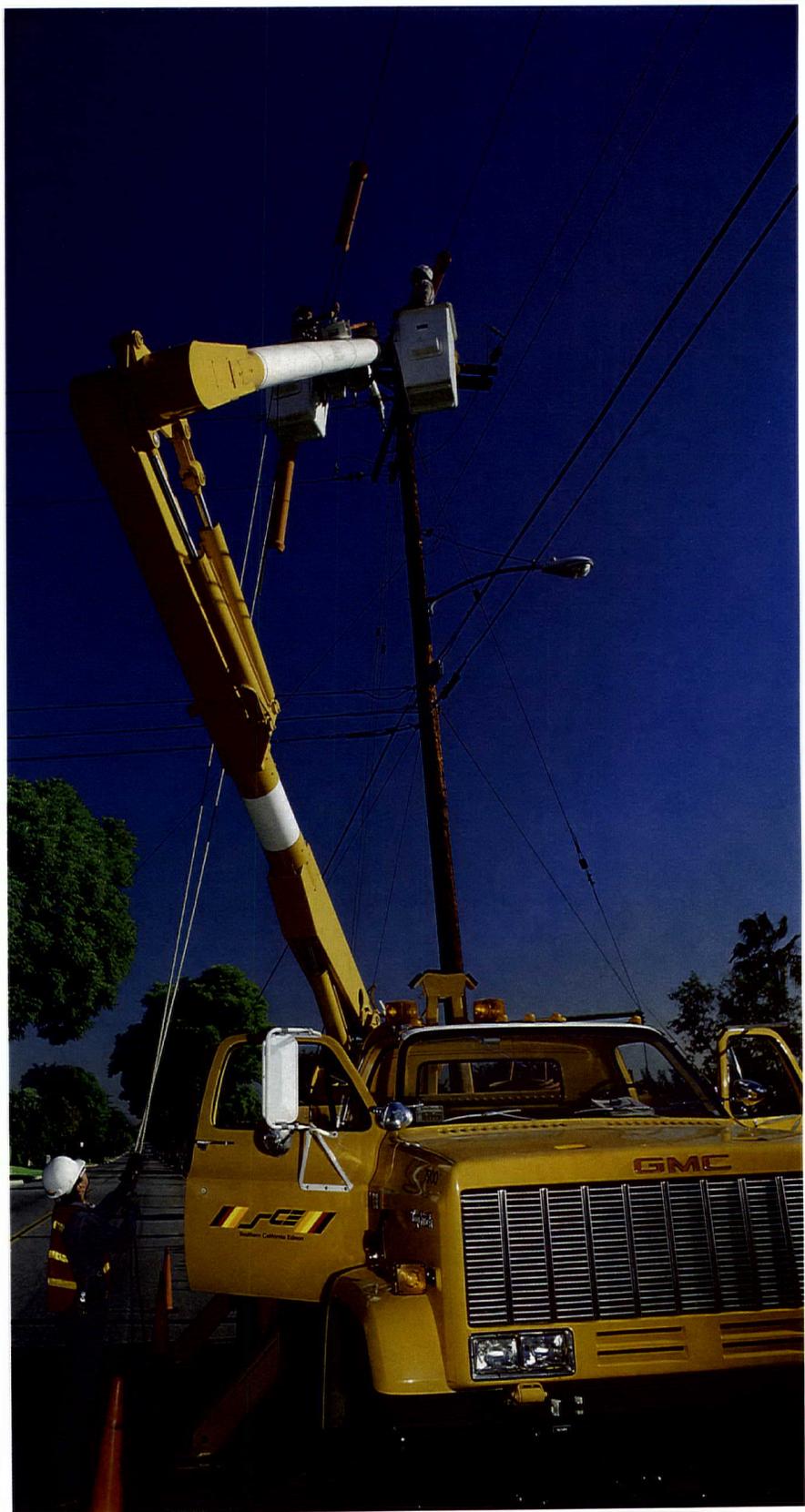
The Company receives five million customer service telephone calls annually in its five telephone information centers. In 1986, the Company significantly increased the accessibility and speed of response at these centers.

Improving the response time to customers is only one of many service improvements achieved in 1986. Others include:

- A new program providing Edison's largest industrial and commercial customers with a single person to coordinate meeting their service needs in a more efficient way;
- Extended office hours to better accommodate customers at selected locations;

Over the years, Edison has developed new equipment for its employees to improve productivity and enhance safety. In 1986, the Company introduced a new double-bucket truck, used during electrical outages as well as for regular maintenance, which gives linemen greater maneuverability around power poles. The truck was designed and assembled by Edison personnel.

In the 1890s, linemen carried around their own equipment in a wheelbarrow when working on power poles.



- The completion of 59,000 free energy surveys for residential customers and an additional 34,000 for industrial, commercial and agricultural customers to promote efficient energy consumption;
- Financial incentives offered to 60,000 customers aimed at partially offsetting the purchase of energy-efficient equipment and appliances;
- Edison also assisted 60,000 low-income customers with a variety of energy management services, including the free installation of energy-efficient appliances;
- An information program for senior citizens involving several Edison retirees on a part-time basis, covering such subjects as safety, heat and cold stress and energy use;
- Toll-free telephone numbers with Edison representatives fluent in Chinese, Vietnamese and Cambodian to assist the growing number of Southeast Asian immigrants not proficient in English; this program augments the existing capabilities for Spanish-speaking customers. The Company also offers customers written materials in Asian languages as well as Spanish.

Today's Business Environment

The Public Utility Regulatory Policies Act of 1978 (PURPA), which was part of the legislation enacted to meet the "energy crisis" of the 1970s, fostered the entry of non-utility companies into the electric generation business. Under PURPA, non-regulated power producers are allowed to build generating plants, and utilities are mandated to purchase the electrical output of these plants at prices set by state regulatory bodies.

Today, although fuel oil and natural gas prices have decreased significantly, Edison is required to continue to buy power from some non-regulated power producers, principally in the biomass and geothermal areas, at prices much higher than the power the Company can now produce or pur-

chase from other sources. This overpricing, which will be about \$185 million in 1987 and could reach \$350 million by 1990, has unfairly increased the cost of electricity to customers.

These unregulated producers are often large consumers of electricity. They are free to either sell the power they generate to Edison, or to use it themselves. Some also seek to sell the power they produce to other large industrial and commercial customers now served by Edison. If they are successful in taking customers away from the utility, the result would be more expensive electrical service for the remaining customers because the fixed costs of service would be spread across a smaller base.

This situation could be further aggravated because some unregulated power producers also are seeking mandatory wheeling, or uncontrolled access to investor-owned utility transmission lines. Mandatory wheeling would benefit a few customers at the expense of all the rest. Currently, subject to certain contractual commitments and regulatory requirements, Edison has the right to determine when to provide transmission service over lines it owns and to give transmission service to others only when it will not interfere with the Company's primary service obligation to its customers.

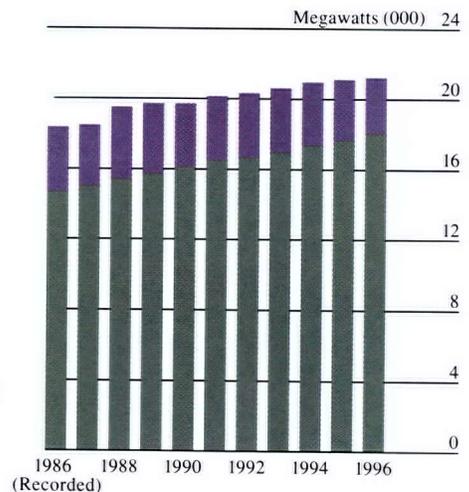
Mandatory wheeling, by contrast, would require that transmission service be provided even if it would interfere with system reliability and increase the overall cost of service. Moreover, mandatory wheeling would provide the benefits of cheaper power to large users at the expense of higher priced electricity for Edison's residential, small commercial and agricultural customers.

The Company is opposing mandatory wheeling at the federal and state government levels.

In addition to PURPA, part of the impetus for self-generation and mandatory wheeling is the fact that under the current state regulated rate structure, larger industrial utility customers pay more for electricity than their cost of service warrants. This is because, over the last 20 years, rates for large customers were increased by the CPUC above actual costs, partly to

Projected Peak Demand and Reserve Margin

■ Reserve Margin
■ Peak Demand



Peak customer demand for electricity in 1986 occurred August 20 when it reached 14,599 megawatts. On that day the Company had a reserve margin of 25.5%. The Company will continue to have sufficient reserves to meet sales growth as projects currently under construction are nearing completion.



A 175-ton transformer is placed inside the huge powerhouse cavern of the Balsam Meadow hydroelectric project, built 1,000 feet underground in the Sierra Nevada as an extension of Edison's Big Creek hydroelectric complex. The 200-megawatt project progressed on schedule

during 1986 and will be Edison's largest hydro plant when it begins operation in December 1987.

In an earlier phase of the Big Creek hydro project, an Edison work crew completed construction of the Florence Lake Tunnel

in 1925, the longest water tunnel in the world at the time. In one month, miners dug through 692 feet of granite, then a record for hard-rock tunnel construction. This record was surpassed by the Balsam Meadow project when crews excavated 1,051 feet of tunnel in 22 days.



encourage energy conservation and partly to subsidize residential rates. Edison's 1988 General Rate Case pending before the CPUC attempts to bring rates back into line with the cost of service.

Unlike the non-regulated power producers, Edison and other electric utilities have the obligation to provide electric service to all customers at regulated rates. In fulfilling this responsibility and public trust, Edison intends to do what it can to avoid having unregulated power producers, who have no limit on their profits and no obligation to serve, from taking advantage of the smaller commercial, residential and agricultural customers the Company now serves.

Current law prevents Edison from competing on a fair basis with these unregulated power producers. Given an opportunity to do so, the Company is confident it can meet the needs of its customers in a fair and equitable manner.

Generating Resources

The Company uses nine different energy resources to generate electricity, more than any other utility in the world. In today's world energy markets, where supply and demand for fuels can change drastically in a short time, this diversity also provides Edison more flexibility in serving customers reliably at reasonable rates.

Nuclear Power

The Company's three units at its San Onofre Nuclear Generating Station generated slightly over 14 percent of the electricity used by customers in 1986. The output of these three units made the burning of about 24 million barrels of oil or equivalent natural gas unnecessary, saving customers over \$230 million in fuel costs in 1986.

During the year, the 1,100-MW San Onofre Units 2 and 3 operated, respectively, at 68 percent and 72 percent of their capacities, surpassing the national industry average for nuclear units. Unit 2 completed its second refueling during 1986, while Unit 3 was taken out of service January 2, 1987, for its second refueling.

The 450-MW Unit 1 returned to service in July after being taken out of service in November 1985 to repair damage to piping in the non-nuclear part of the plant caused by an equipment malfunction. During the outage, the Company completed a scheduled refueling, and made seismic and other modifications required by the federal Nuclear Regulatory Commission.

Edison has an 80 percent ownership interest in Unit 1, and a 75 percent interest in Units 2 and 3. The Company is responsible for managing and operating the three San Onofre units.

Edison also has a 15.8 percent interest in the Palo Verde Nuclear Generating Station, located near Phoenix, Arizona. The project, managed by the Arizona Public Service Company, will be the largest nuclear facility in the United States when its three 1,221-MW units are completed.

During the year, two Palo Verde units went into commercial operation—Unit 1 on February 1 and Unit 2 on September 19. Unit 3 is scheduled for commercial operation in late 1987.

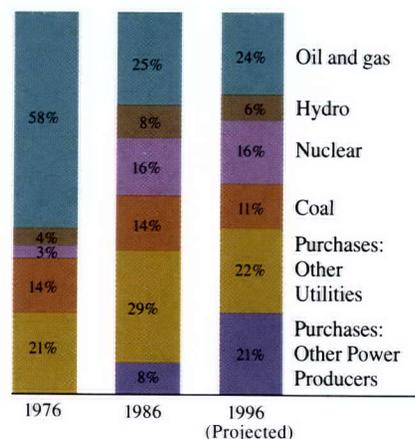
Hydro Resources

Construction continued on schedule and under budget on the 200-MW Balsam Meadow project, a major addition to Edison's Big Creek hydroelectric complex located northeast of Fresno, California, in the Sierra Nevada.

Scheduled for operation in December 1987, the facility will be Edison's largest hydroelectric unit. The underground powerhouse will be named the John S. Eastwood Power Station, in honor of the engineer who conceived the Big Creek hydroelectric complex.

Edison has requested authorization from the Federal Energy Regulatory Commission and the CPUC for the Balsam Meadow project to operate as a "pumped-storage" system. If this proposed system is approved, water would be pumped up to a reservoir at night using less expensive power, then released to drive the turbine generator during daytime peak periods. This will help the Company reduce the cost of producing electricity in peak periods for its customers.

Generation Energy Mix

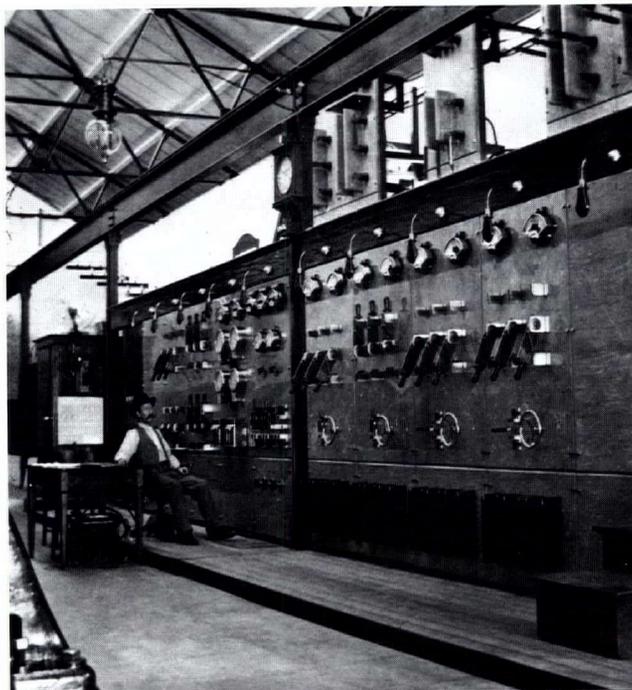


The Company uses nine different energy resources to generate electricity, more than any other utility in the world. In today's world energy market, this diversity provides Edison flexibility in serving customers reliably. The Company has reduced its dependence on oil and gas from 58% in 1976 to 25% in 1986.



Control operator Mark Stuckey adjusts the highly sophisticated, computerized control room equipment for Unit 2 at the Ormond Beach generating plant in Oxnard. During 1986, the Company completed major modifications to the 750-megawatt unit that enabled it to operate at a lower minimum load, thereby giving it greater flexibility and reducing overall costs to customers.

In an earlier era, switchboard controlling units, such as the one at the Santa Ana River No. 1 hydro plant that was completed in 1899, were manually operated, requiring a diligent eye and dexterity to maintain proper power levels.



Coal Power

Edison's coal-fired power plants in Nevada and New Mexico generated 14 percent of the electricity the Company produced for its customers in 1986.

The two units at the Mohave Generating Station in Nevada set a record in 1986 by operating at 72 percent of capacity, well above the national average for coal-fired plants. Since coal is one of Edison's least expensive generating resources, Mohave's 1986 production meant significant savings for Edison customers.

In 1986, the CPUC granted Edison a one-time \$27 million reward in rates for the efficient operation of its coal-fired plants in 1984, based upon a Coal Plant Incentive Program established by the Commission.

Edison owns 56 percent of the 790-MW Mohave units and 48 percent of two 790-MW coal-fired units at Four Corners in New Mexico.

Oil and Natural Gas

Oil- and natural gas-fired generating units remain the backbone of Edison's diversified electric generating system, which helps to maintain the reliability of electric service to its customers.

Edison has 47 oil- and gas-fired generating units with a total capacity of slightly over 10,000 MW.

In 1986, Edison produced 25 percent of its customers' electricity from its oil- and natural gas-fueled power plants. This small utilization of oil and gas resources is because the Company purchased 37 percent of its power sales from outside sources, at less than the cost of generating electricity with oil or gas on its system.

Non-Regulated Power Producers

Although the sharp drop in the prices of fuel oil and natural gas has reduced the cost-competitiveness of many renewable and alternative resources, these technologies continue to represent important components of the Company's diverse energy resource mix.

At the end of 1986, there were 211 non-regulated power projects owned and operated by independent power

producers contributing 845 MW to the Edison system. There are an additional 198 projects under contract from unregulated producers, representing another potential 3,513 MW.

For a number of reasons, including changes in federal tax laws, air quality considerations, and siting and permit requirements, the Company estimates that only about 40 percent of planned projects will actually be built.

The California Energy Commission, which is the state licensing agency for all thermal projects of 50 MW or more, issued new guidelines in 1986 on non-regulated power projects that should reduce unfair costs to customers. First, these guidelines give Edison and other California utilities the opportunity to meet the electric service needs of large industrial customers before they can undertake their own energy projects. Second, all new power purchase contracts between utilities and non-regulated producers must take into account the electric generating requirements of utilities. As a consequence, this allows utilities to reduce their power purchases from these non-regulated producers when less costly alternative power is available, such as purchases of economy energy from the Pacific Northwest and Southwest.

The large number of contracts between Edison and non-regulated power producers resulted from the implementation of PURPA. The legislation required electric utilities to purchase all the renewable/alternative power produced by independent producers at "avoided cost"—which is defined as the replacement cost of the

energy and capacity that a utility would otherwise generate from its own plants or obtain from other sources.

In California, the CPUC prescribed the terms for utilities to buy power from unregulated power producers. One pricing formula was based on a 1983 forecast of oil prices. Before its use was suspended by the CPUC in April 1985, unregulated power producers submitted a large number of new contracts that obligated Edison to purchase power at prices significantly higher than its current avoided cost. This has resulted in unfair and unnecessary costs to customers for power from independent producers that is already on-line and additional costs for power projects not yet built. The Company is working hard in a number of ways to protect consumers from this unfair pricing, including the close monitoring and administration of the terms of these contracts.

Purchased Power

In 1986, Edison obtained 37 percent of the electricity it provided customers from outside sources, primarily other utilities in the Pacific Northwest and Southwest who use hydro and coal resources. Most of these purchases were on the "spot market" and were actively sought by Edison because of their lower cost. Even with the substantial decline in oil and natural gas prices, these spot market purchases saved customers about \$140 million during 1986, compared with using natural gas as a fuel in its own generating plants.

Resources from Non-Regulated Power Producers

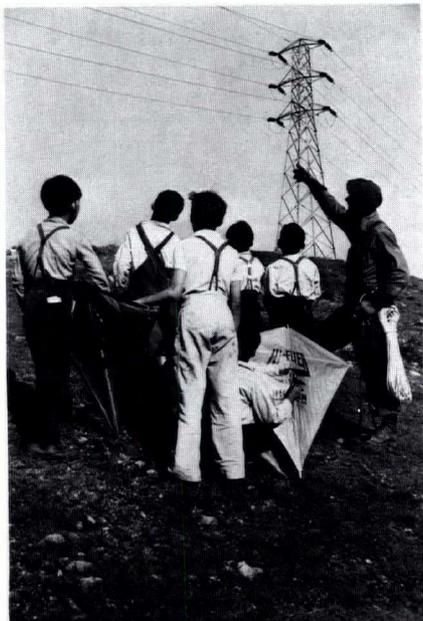
	Under Contract But Not Built		On-Line	
	No. of Projects	Megawatts Capacity	No. of Projects	Megawatts Capacity
Biomass	27	592	22	82
Cogeneration	42	1,476	77	411
Geothermal	22	696	5	100
Small Hydro	28	10	32	54
Solar	17	558	21	105
Wind	62	181	54	93
Total	<u>198</u>	<u>3,513</u>	<u>211</u>	<u>845</u>



Edison educational service representatives Jon Sirugo and Jim Burns conduct a science demonstration for sixth grade students as part of the Company's new "Science Connection" educational program that was inaugurated in 1986. The program, a joint project by Edison and the Jet Propulsion Laboratory, with support from the National Aeronautics and Space Administration, features a mobile high-technology

classroom equipped with lasers, robots, fiber optics, computers and state-of-the-art audiovisual components.

The Company's early education programs were more "hands on" than "high tech." Kite safety programs, which began in the 1930s, featured on-the-spot lectures by linemen.



During the year, Edison worked to increase its long-term access to economical, out-of-state power by entering into new long-term contracts. The Company signed a 25-year contract with Portland General Electric Company that should save Edison customers about \$200 million during that period. The new contract provides Edison with up to 300 MW during its summer peak period and supplies Portland General Electric with access to power to meet its winter peak.

In addition, the Company and several other California and Pacific Northwest utilities signed an agreement with British Columbia Hydro to study the feasibility of a proposed 900-MW hydroelectric project in British Columbia.

Northwest Transmission

The major link for exchanging power between California and the Pacific Northwest is the Pacific Intertie transmission system, which was built during the 1960s. 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.

This transmission system benefits both regions, allowing the Northwest to market its surplus power and making California energy sources available to the Northwest. The Pacific Intertie transmission system has saved Edison customers millions of dollars each year since its construction.

In October, construction began on a project to increase the transmission capacity of the Pacific Intertie DC line from 1,958 to 2,990 MW. This line is jointly owned by Edison, the Los Angeles Department of Water and Power and the municipal utilities of Glendale, Pasadena and Burbank. When the project is completed in 1989, Edison's transmission capacity over the line will increase from 421 MW to 643 MW.

During the year, planning also continued on the construction of a third AC line to the Pacific Northwest. The proposed line, known as the California-Oregon Transmission Project, would add about 1,600 MW

of new transmission capacity by 1991, including Edison's share of about 280 MW.

The completion of all planned improvements in these lines will increase the total transfer capacity between California and the Pacific Northwest to approximately 7,790 MW, with Edison's transmission capability climbing from 1,281 MW to over 1,900 MW.

Southwest Transmission

A major step in expanding transmission between California and the Southwest was taken when Edison filed an application with the CPUC to construct a second high-voltage AC line from the Palo Verde Nuclear Generating Station near Phoenix, Arizona, to the Devers Substation, near Palm Springs. If approved, this proposed 1,200-MW line will provide Edison with about 600 MW of new transmission capacity in 1990, with the remaining 600 MW being shared by other California utilities.

Bonneville Power Policy

The Bonneville Power Administration (BPA), a federal power marketing agency in the Pacific Northwest and a major supplier of power purchased by Edison, has adopted various policies intended to increase its revenues and those of Pacific Northwest utilities from sales of surplus electricity to Edison and other California utilities. Most of this electricity sold by BPA is generated by low-cost, federally subsidized hydroelectric facilities.

BPA has priced the surplus energy sold to California at levels well above its production costs, and has restricted access to the Pacific Intertie by Pacific Northwest and western Canadian utilities. This has increased prices and reduced electricity sales to California utilities. In October, BPA issued its draft proposal for a long-term policy on access to the Pacific Intertie which, if adopted, would further increase these restrictions with an adverse impact on California utility customers.

These policies of BPA have unfairly increased purchased power costs to California electric consumers. Edison opposes BPA's rate structure and its

access policy, and is working in conjunction with other California public and investor-owned utilities to have these policies modified.

Fuel and Purchased Power Costs

Edison's fuel and purchased power costs dropped 31 percent to \$1.65 billion in 1986 from \$2.39 billion in 1985, primarily as a result of lower oil and natural gas prices. Although these costs were lower than in any year since 1979, fuel and power purchases continued to be the single largest component of the total cost of providing electric service to customers, representing 32 cents out of each revenue dollar.

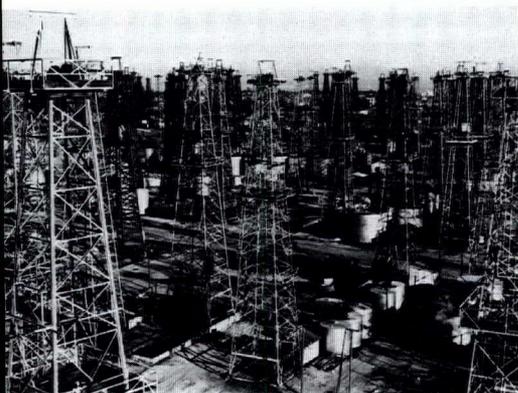
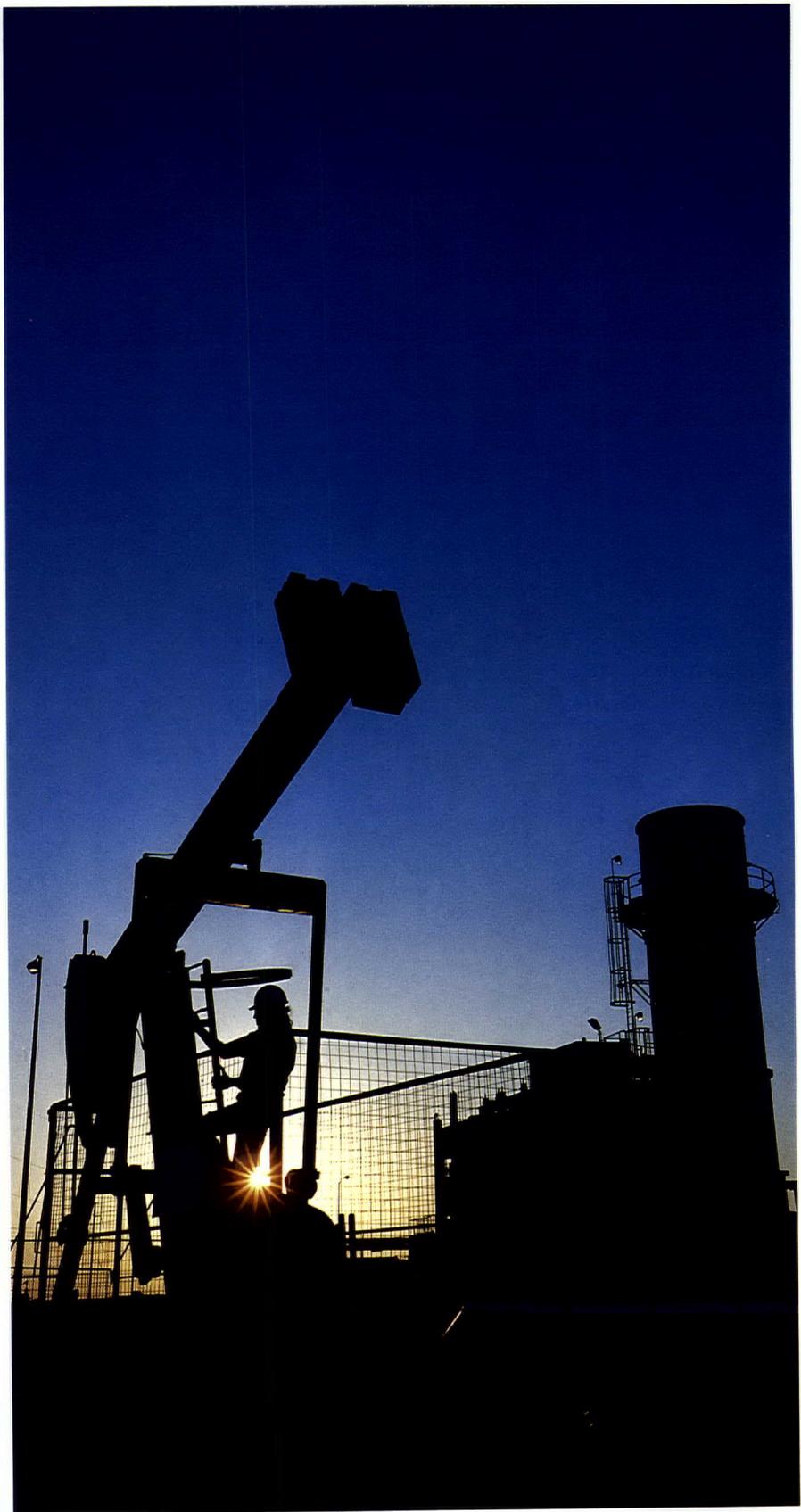
During the year, Edison negotiated several reductions in the price of its natural gas purchases that kept suppliers of this fuel competitive with the decreasing price of oil. Edison also was able, for the first time, to purchase small quantities of low-cost gas—about 3 percent of its total purchases—directly from sources outside California for delivery to its power plants. As a result, the Company's average gas price in 1986 of \$2.58 per million Btu was almost 40 percent lower than in 1985. This reduced fuel costs and saved Edison customers about \$300 million.

Furthermore, sellers of "spot market" power from the Pacific Northwest and Southwest had to compete with lower prices for natural gas by reducing the cost of economy energy purchased by Edison. The average cost of these energy purchases in 1986 was 1.7 cents per KWH, 32 percent below the 1985 average of 2.5 cents per KWH. This reduced the cost of purchased power and saved Edison customers about \$100 million.

By comparison, the highest average price Edison paid for purchased energy and capacity was from independent power producers at 5.9 cents per KWH. As described earlier, this high price was, in large part, the result of a pricing formula mandated by the CPUC for utility power purchases from independent power producers under the 1978 Public Utility Regulatory Policies Act.

To seek new business opportunities in areas other than the regulated utility business, Edison established a non-utility subsidiary, Mission Energy Company, which has become one of the largest cogeneration companies in the United States. Its first project, a joint venture with a Texaco subsidiary, was the Kern River Cogeneration Project that generates 300 megawatts of electricity, then utilizes the exhaust heat from the turbines to produce steam for more efficient oil-recovery operations.

In the late 1930s, Edison also sought new business opportunities when it mounted vigorous campaigns to increase kilowatt-hour sales to its customers. In one successful program, Edison engineers persuaded many oil field operators to convert their steam-powered pumps to more efficient electric pumps, thereby producing more oil for sale.



The availability of natural gas, purchased power, and to a lesser extent, renewable and alternative resources helped minimize consumption of fuel oil. The Company burned only 1.3 million barrels of oil in 1986, compared to nearly 58 million in the peak year of 1977. By comparison, a decade ago Edison projected that it would need to burn more than 80 million barrels of fuel oil in 1986.

New Planning and Research Strategies

In 1986, Edison adopted a new strategy in its resource planning process to better prepare the Company for future uncertainties. It focuses on flexibility and timely responsiveness to change by including contingency resource plans to meet unforeseen world and national events or unpredictable changes in energy supply and use. As a result, the Company is positioned to provide reliable electric service to customers even with continued changes in the business environment and unexpected growth patterns.

In addition, Edison moved to change the direction of its research programs to provide customers with a better value for their energy dollar. This new approach emphasizes improved reliability and quality of electric service, greater efficiency and new service options for customers. At the same time, the new direction complements the Company's continued research on plant operation improvements, alternative fuels and emission controls.

A major focus of Edison's research program is the development of a reliable, low-cost communications network between the Company and its customers as a means of providing them access to a variety of energy service programs and information services. This communication system would enable Edison customers to reduce their overall energy costs by shifting some of their electric consumption to low-cost periods.

A test program for 2,500 customers is scheduled for 1987 to determine the feasibility of the pilot program known as the Network Communications System. If successful, Edison could be the

first electric utility in the country to offer a two-way data communications network to its customers.

The Company's new research thrust also includes greater emphasis on technologies that will help it to become a more diversified supplier of energy services. These technologies include more productive heating and air conditioning systems, more energy-efficient household appliances, and advanced electrical equipment used by customers.

In addition, the Company is testing several promising energy storage technologies, including a 10-MW project that will be the world's largest battery-energy system when it goes into operation in 1988.

Coal Gasification

The Cool Water Coal Gasification plant, located near Daggett, California, successfully completed the second year of a five-year test program to determine its commercial feasibility. The 100-MW plant combines new and existing technologies in an environmentally clean process to convert a wide variety of coals—including high-sulfur coal—into a synthetic gas used in turbines to generate electricity.

Emissions from the demonstration plant have been as low as one-tenth of those allowed by the U.S. Environmental Protection Agency for coal plants. The testing program has provided valuable information on this technology. With today's low fuel prices, however, this demonstration plant is not commercially competitive with other generating resources. With more favorable economic conditions in the future, however, this technology could be a valuable resource in utilizing the country's domestic coal resources and protecting air quality.

In addition to Edison, other project participants include Texaco Inc., Bechtel Power Corporation, General Electric Company, the Electric Power Research Institute and the Japan Cool Water Partnership.

Non-Utility Subsidiaries

During 1986, the Company established four non-utility subsidiaries to develop

business opportunities in several unregulated markets. These non-utility subsidiaries are separate from Edison's regulated business and are not eligible for recovery of costs or return through utility ratemaking.

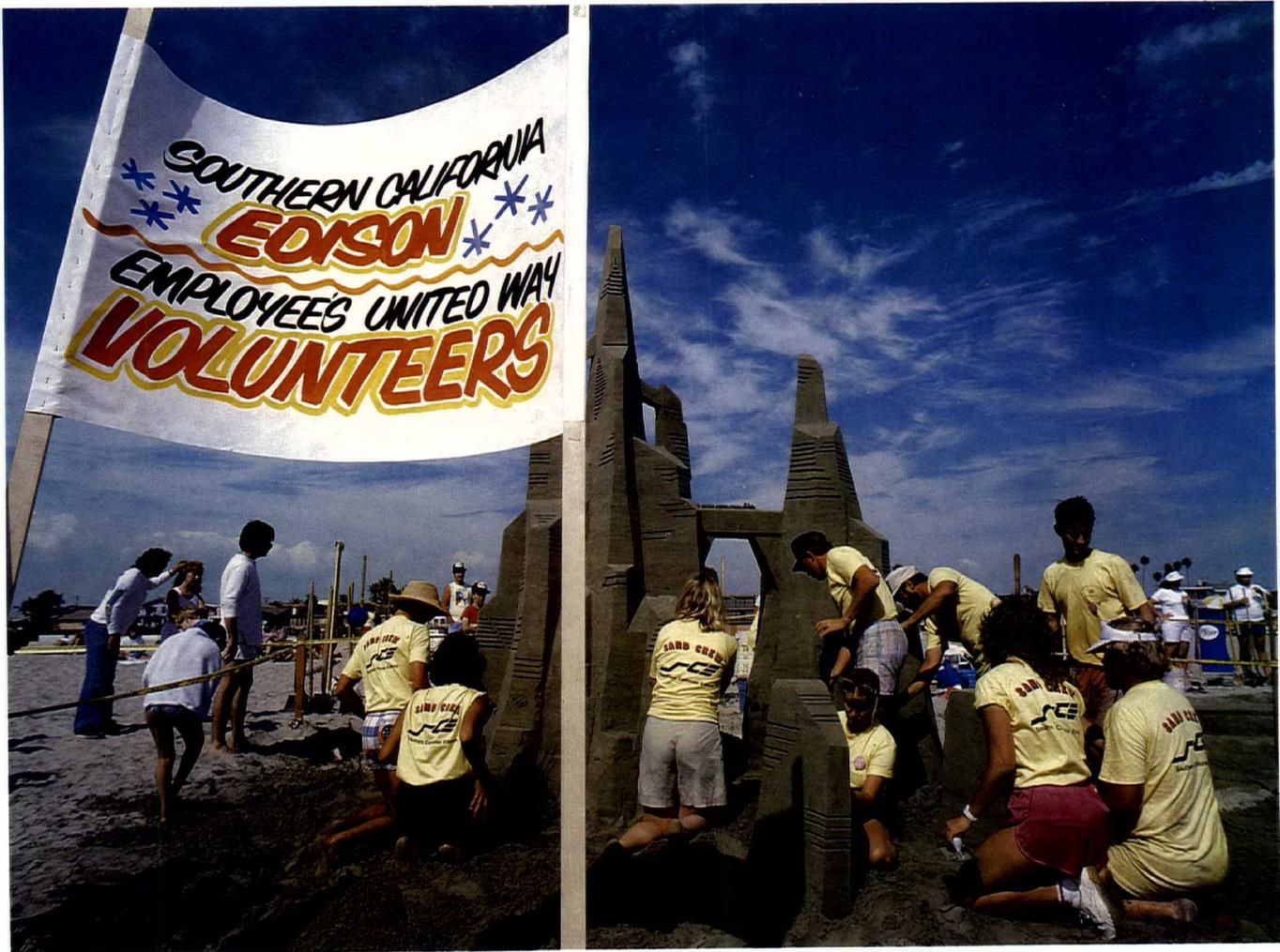
The capital committed to these ventures is modest compared with Edison's involvement in utility operations. At year-end 1986, Edison's equity in these non-utility subsidiaries totaled \$147 million. In total, the subsidiaries contributed 6 cents per share to the Company's 1986 earnings. Although small now, in time and under certain circumstances these non-regulated business enterprises could become more significant contributors to the Company's earnings.

Mission Energy Company, the largest subsidiary, is located in Irvine, California, and is engaged in the development of electric generation projects nationwide through joint-venture partnerships in the cogeneration and alternative energy areas. At year end, Mission Energy had 315 MW of capacity in operation and another 1,000 MW under development.

Major projects in operation include the 300-MW Omar Hill cogeneration facility near Bakersfield, and the 15-MW Beowawe geothermal plant near Elko, Nevada. Major cogeneration projects under development in California include two in the Bakersfield area—the 300-MW Sycamore and 225-MW Midway/Sunset projects. There also are two near Long Beach—the 385-MW Watson and the 80-MW Harbor projects.

Mission Land Company, based in Garden Grove, California, owns and operates industrial parks in a number of Southern California cities, including Paramount, Brea and Garden Grove. There also are plans to develop other industrial parks in Ontario and Rancho Cucamonga.

Mission Power Engineering Company, located in Irvine, California, provides consulting to outside clients on engineering and construction services in the energy field. Its projects have included transmission lines, substations, switchyards, cogeneration plants, and electric power generating facilities using geothermal and other resources.



Edison volunteers put the final touches on their winning 14-foot-tall entry in a sand sculpturing contest sponsored by United Way of Orange County to raise funds for the needy and underprivileged.

The Company and its employees have a long tradition of donating money and volunteering their time and energy to numerous civic, charitable, religious and public organizations throughout Edison's service territory. As an early example, after the 1933 Long Beach earthquake Edison employees loaned their electric cooking appliances to the Red Cross for its relief efforts, with the Company providing tents and portable kitchens.



Mission Financial Management Company, as yet inactive, was formed to invest in high-quality securities, leasing activities and other financial undertakings.

Edison People

The successes of 1986 reflect the hard work, dedication and innovation of more than 17,500 Edison employees. They are the Company's greatest asset, whether they are the service crews and support personnel working long hours to restore power during storms, power plant operators who keep the generating stations running smoothly, or engineers, accountants, clerical workers, meter readers and thousands of other people working efficiently behind the scenes to provide the best possible service to customers and a competitive return to shareholders.

In recognition of the many changes taking place in the electric utility industry, Edison continues to create and expand training, incentive and recognition programs to improve employee work skills and attitudes to help them better respond to new challenges.

Affirmative Action

Edison continued to increase the proportion of both minorities and women in its work force during 1986. Minority representation rose to 30 percent from 29.1 percent in 1985, and female employees increased to 24.7 percent from 24.2 percent in the previous year. During the last five years, minorities in management positions increased to 20 percent from 15.5 percent, while management positions held by females

rose to 19 percent from 13.7 percent.

Edison established a Female and Minority Business program within its procurement division in 1979. Since then, the number of female and minority businesses qualified to do business with Edison has risen by more than 300 percent, from 207 to 896. Total contracts awarded competitively to these firms increased in value from \$3.7 million in 1979 to \$75 million during 1986.

Community Involvement

In addition to serving customers on the job, the Company and its employees contribute in a variety of ways to improving the quality of life in the cities and communities they serve.

The Company encourages its employees to participate in many community service activities, such as the YMCA and YWCA, the Special Olympics, scouting and programs for senior citizens. Besides these activities, the Company also supports a wide variety of cultural and educational programs in communities throughout its service territory.

Education Programs

Edison has a long tradition of providing support and assistance to education. For students, the Company has three separate scholarship programs, and through its Educational Advisory Council, the Company works closely with teachers, administrators and community leaders to develop effective educational materials that can be used to teach students about electrical safety, energy conservation, environ-

mental science, solar energy and other energy-related topics. The Company provides extensive educational materials to schools within its service territory. It also supports youth organizations such as Junior Achievement and the Explorer Scout program.

During 1986, Edison introduced The Science Connection, a new education program aimed at stimulating student interest in science and technology and acquainting teachers with a variety of high-technology teaching resources. In a partnership with the Jet Propulsion Laboratory and the National Aeronautics and Space Administration, the unique project features the use of a 40-foot van serving as a mobile classroom, equipped with lasers, robots, fiber optics and computers.

Emergency Alert Service

In a new community service offered systemwide during 1986, Edison employees in vehicles with two-way radios can now relay calls for help from citizens to emergency agencies, such as paramedics, police and fire departments. These Edison vehicles are identified with a decal reading "Emergency Alert Service, Radio-Equipped Vehicle."

United Way Campaign

In 1986, Edison employees contributed \$2.35 million to the United Way. On a per capita basis, this placed Edison people among the leading contributors in California to United Way and the more than 900 charitable organizations it supports.

Percentage of Male, Female and Minority Employees at Year-End 1981 and 1986	Male %		Female %		Black %		Asian American %		American Indian %		Hispanic %		Total Minorities %	
	Year-End 1981	Year-End 1986	Year-End 1981	Year-End 1986	Year-End 1981	Year-End 1986	Year-End 1981	Year-End 1986	Year-End 1981	Year-End 1986	Year-End 1981	Year-End 1986	Year-End 1981	Year-End 1986
Management ⁽¹⁾	86.3	81.0	13.7	19.0	3.2	3.9	5.1	6.7	0.5	0.4	6.7	9.0	15.5	20.0
Administrative & Operative ⁽²⁾	76.0	72.1	24.0	27.9	8.9	9.4	3.1	4.0	1.0	1.2	17.3	21.0	30.2	35.6
Total Company ⁽³⁾	79.4	75.3	20.6	24.7	7.0	7.4	3.7	4.9	0.8	0.9	13.8	16.8	25.4	30.0

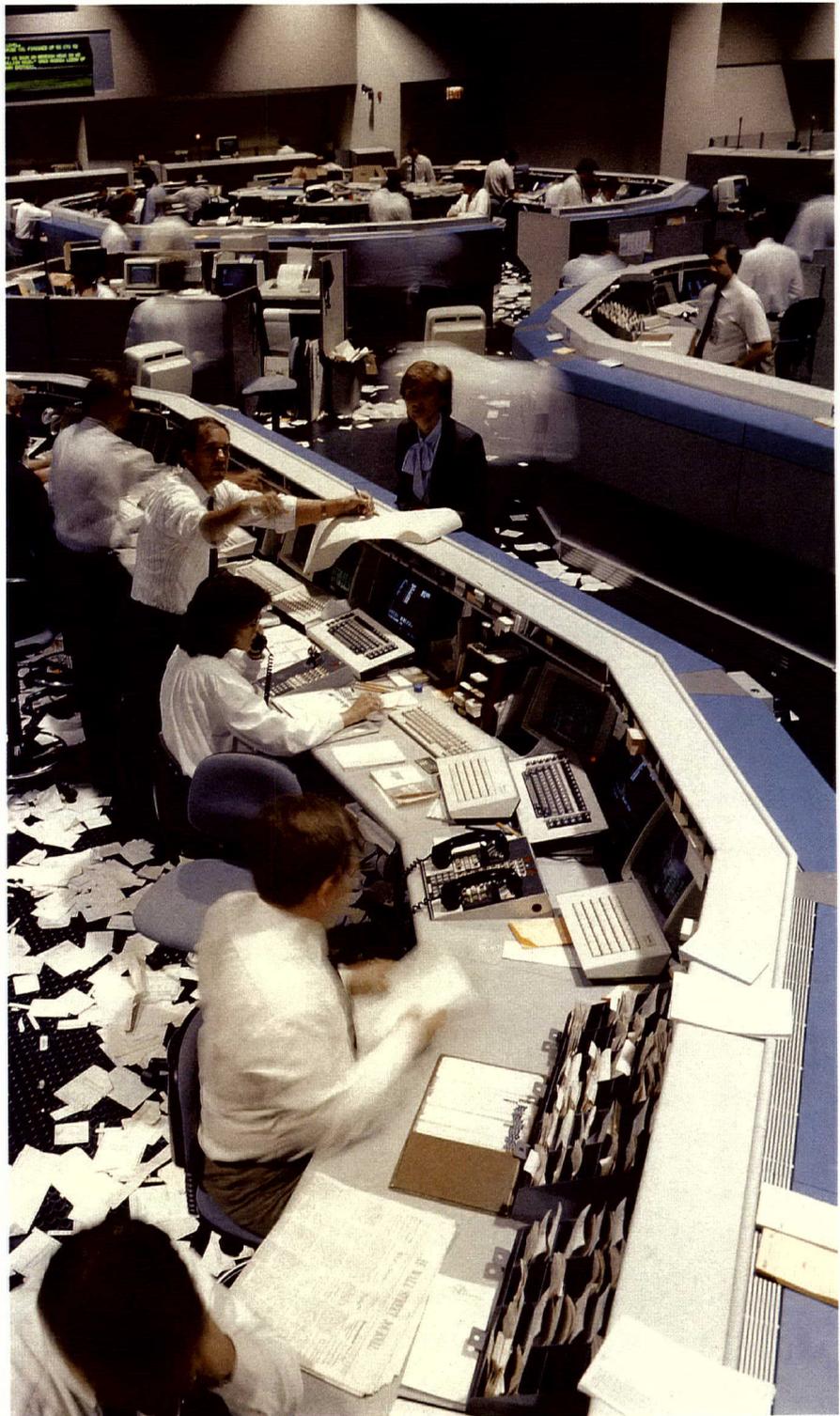
(1) Management employees include the "Officials and Managers" and "Professionals" affirmative action categories.

(2) Administrative and Operative employees include the "Technicians," "Office and Clerical," "Craftsmen," "Operators," "Laborers," and "Service Workers" categories.

(3) Includes all classes of employees.

Edison common stock traded at record-high prices in 1986 and outperformed both the Dow Jones utility average and the Dow Jones industrial average. Lois Ingham, manager of Investor Relations for Edison, discusses the trading activity of Edison common stock at the new Pacific Stock Exchange in Los Angeles with Mike Harper, the specialist who executes buy and sell orders for the Company's securities.

In 1917, the Company adopted as one of its fundamental policies the sale of stock directly to customers, employees and the local public. Edison's Securities Department facilitated the sale of stock directly to the public, including the multi-million dollar financing of Big Creek hydroelectric projects in the 1920s.



Financial Review

The Company recorded significant financial achievements in 1986, including:

- Earnings per share reached an all-time high of \$3.28 for the sixth consecutive year of record earnings;
- The Board of Directors increased the common stock dividend 5.6 percent to \$2.28 per share annually, the 11th increase in the past 10 years;
- Total return to common stock shareholders from stock appreciation and dividends was almost 36 percent, significantly exceeding both the Dow Jones utility average and the Dow Jones industrial average. The Company's average compound annual return of 28.5 percent over the past five years also has outperformed the Dow Jones averages over the same period;
- The market price of common stock reached an all-time high of \$38¾ per share on August 21, 1986;
- The quality of earnings reached its highest level since 1974 as the percentage of earnings exclusive of non-cash Allowance for Funds Used During Construction increased to 81 percent;
- Taking advantage of declining interest rates, the Company issued a record \$1.7 billion of debt, all of which was used to refinance higher-cost securities. The Company reduced its weighted average cost of outstanding debt to 9.1 percent, lower than any other major California utility;
- Interest coverage, although down slightly from the 1985 level, at 4.2 times remains well above the industry average;
- Internal generation of funds reached 80 percent of capital requirements, the most favorable level in over 25 years.

Record Earnings and Revenues

Earnings and revenues for 1986 set new records at \$714 million and \$5.3 billion, respectively.

Earnings per share of common stock of \$3.28 were up moderately from \$3.26 earned in 1985. Earnings per share have grown at an annual compound rate of 5.9 percent over the past five years.

The rate of return earned on common equity was 15.1 percent, exceeding the 14.6 percent level authorized by the CPUC. However, the return on common equity would have been 14.8 percent without the coal plant incentive award authorized by the CPUC.

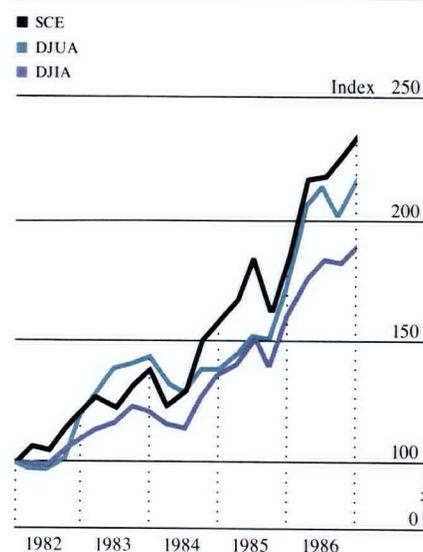
Contributing to the high level of earnings for 1986 were lower interest costs and preferred dividends resulting from the Company's aggressive re-financing program, continued emphasis on cost control and productivity, and the reward for favorable coal plant operating performance. The increased earnings were achieved despite a downward adjustment in the Company's authorized rate of return on common equity from 16 percent to 14.6 percent and refunds to wholesale customers resulting from Federal Energy Regulatory Commission rate decisions.

Earnings also reflected a \$15 million, or 7 cents per share, charge against income related to the portion of the CPUC's investment disallowances for San Onofre and Palo Verde that the Company did not appeal.

In terms of the financial impact of the portion of the disallowance being appealed, it is currently estimated that if the appeals were denied in their entirety, write-offs for San Onofre and Palo Verde would total \$314 million. This amount, which may be affected by the timing and the outcome of both the appeal to the CPUC for rehearing and a possible appeal to the California Supreme Court, is comprised of \$102 million, or 47 cents per share, for past revenue collections that would be treated as a charge against earnings in 1987 and \$212 million, or 97 cents per share, for a one-time rate-base adjustment that would be reflected as a restatement of prior earnings. These amounts and financial reporting methods assume that the appeals will be decided during 1987, which is currently anticipated.

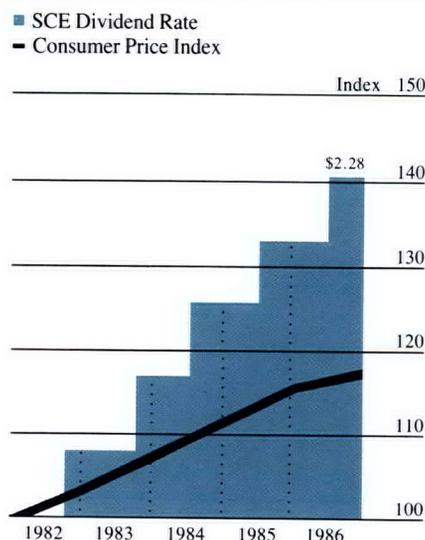
For additional information on the financial implications of this matter, please refer to Note 2 of "Notes to Financial Statements" on page 46.

Stock Price Comparison



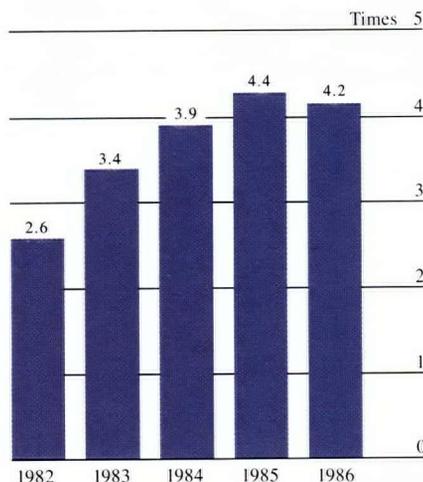
The Company's stock price has increased almost 2½ times during the past five years, outpacing both the Dow Jones utility average and the Dow Jones industrial average.

Dividend Increases Compared with Inflation



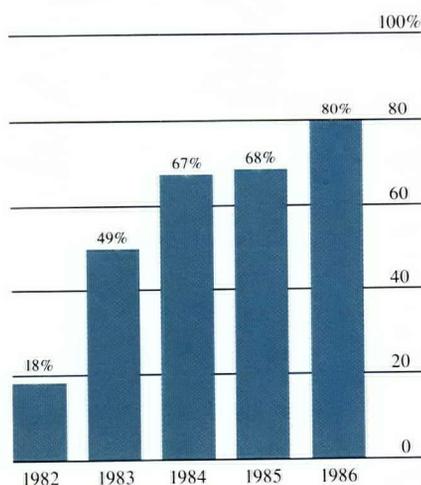
The Board of Directors increased the dividend on common stock 5.6% to \$2.28 per share in 1986, the 11th increase in the past 10 years. Dividend increases continued to outpace inflation as measured by the Consumer Price Index.

Pretax Interest Coverage



Earnings before income taxes and interest charges on debt were 4.2 times greater than debt service costs. Even though 1986 interest coverage was down slightly from 1985, a ratio of 4.2 times is excellent and significantly higher than the industry average.

Internal Generation of Funds



With major new generating facilities included in customer rates, there has been substantial improvement in Edison's internal generation of funds. In 1986, the Company met 80% of its capital requirements internally, the highest level in more than 25 years.

Rate of Return Reduced

The CPUC, in August, concluded its review of the authorized rate of return on common equity for all major California energy utilities. This review was undertaken because of significantly lower inflation and interest rates. The CPUC approved a stipulation negotiated between its Public Staff Division and Edison regarding rate of return on common equity and capital structure for 1986 and 1987.

The approved stipulation reduced the Company's authorized return on common equity from 16 percent to 14.6 percent in 1986 and to 13.9 percent in 1987. The effect of these reduced returns was partially offset by increasing the equity portion of the Company's capital structure from 45 percent to 47 percent. The impact of the decision, independent of other factors, was to reduce authorized earning levels by 17 cents per share in 1986 and by an additional 16 cents per share in 1987.

Dividend Increase

In keeping with the Company's intent to provide a competitive return to common shareholders, the Board of Directors in June increased the Company's common stock dividend for the 11th time in the past 10 years. Over that time, the annual dividend growth rate has exceeded the rate of inflation by 2.5 percentage points. The new annual dividend rate of \$2.28 per share is 5.6 percent higher than the previous annual rate of \$2.16 per share. The current dividend provided a 6.7 percent yield on Edison's year-end common stock market price of \$33³/₈ per share.

Dividend Reinvestment and Stock Purchase Plan

The Company continues to offer a Dividend Reinvestment and Stock Purchase Plan as an investment option for its common stock shareholders. At year end, over 40,000 shareholders, or about 25 percent of the holders of Edison common stock, were participating

in the plan. These participants purchased approximately 1.7 million shares by investing over \$52 million of dividends and optional payments.

Credit-Watch System

Edison was the first U.S. utility to operate an early warning credit system that tracks the creditworthiness of its 350,000 commercial and industrial customers. The system is designed to identify customers who are in danger of business failure. Once identified, arrangements are made to ensure that those customers will remain current on their electric bills through cash deposits, surety bonds or more frequent payments. This saves money for all Edison customers by reducing the amount written off as bad debt.

In 1986, the Edison credit-watch system reduced write-offs by \$2.2 million, bringing total savings to \$6.5 million since it began five years ago.

Capitalization

The Company's total capitalization at year end was \$10.1 billion. Over the past five years, capitalization has grown at an average annual rate of 6.8 percent. The capital structure at year-end 1986 was composed of 47.3 percent common equity, 6.6 percent preferred and preference stock and 46.1 percent long-term debt.

Corporate Financings

In 1986, Edison entered the capital markets nine times, completing \$1.7 billion of financings—the largest financing program in the Company's history. None of this amount represented requirements for new capital. Rather, the financings were used to refund higher-cost securities with lower-cost debt. These refinancings were accomplished through aggressive

use of call provisions, market tender programs and open market purchases.

Since the Company began its re-financing program in late 1984 when interest rates started to decline, Edison has issued more than \$2.7 billion of debt, mostly to refinance higher-cost securities, saving customers over \$70 million in interest costs annually.

During the past three years, the Company has actively utilized provisions of the federal tax law to pursue the benefits of tax-exempt financing of pollution control equipment at the San Onofre and Palo Verde nuclear plants. The result of these efforts was the issuance of over \$575 million in variable rate tax-exempt bonds. The variable rate structure of these bonds has provided Edison with some of the lowest financing costs available in the capital markets. The average rate for 1986 was 4.5 percent.

These financings, along with maintaining a high quality AA bond rating, have contributed to the reduction of Edison's average cost of debt from 10.5 percent at year-end 1983 to 9.1 percent at year-end 1986. This is the lowest cost among all the major California utilities.

Edison is the only major California utility whose bonds have not been downgraded by Moody's or Standard & Poor's since these agencies first rated the Company's bonds.

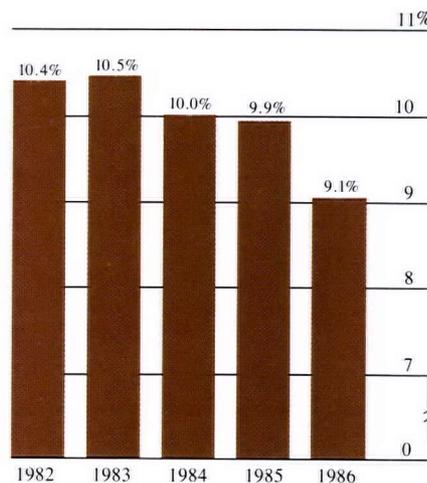
Although the Company's improved internal generation of funds has reduced the need for new money to fund its construction program, Edison foresees another active financing program in 1987. This program includes financing for a moderate amount of new money as well as the redemption of high-coupon debt, maturing bond issues, sinking funds, and the restructuring of the nuclear fuel financing. To meet these needs, Edison will continue to monitor the domestic, European and Japanese financial markets to seek the lowest-cost sources of capital.

1986 Financing Program

Series	Term (Years)	Amount (Millions)
NEW ISSUES		
First and Refunding Mortgage Bonds:		
86A, 9¼%	30	\$ 300
86B, 8⅝%	32	200
86C, 8⅝%	33	200
86D-G, Pollution Control, Var. Rate	22	196
86H, 8%	10	200
86I, 7¾%	10	200
86J, Pollution Control, 7.2%	29	8
86K, 8⅝%	31	125
Total Bonds Issued		1,429
Commercial Paper	Not Applicable	313
Total New Issues		1,742
RETIREMENTS		
First and Refunding Mortgage Bonds:		
N, 4½%	(30)	
Calectric, 4½%	(8)	
Ongoing:		
Sinking Fund Obligations	(34)	
REDEMPTIONS*		
First and Refunding Mortgage Bonds:		
85A, 13%, due 2015 (tender/purchase)	(174)	
MM, 11¾%, due 2004 (call)	(218)	
PP, 15¼%, due 1991 (call)	(209)	
ZZ, 12¾%, due 2013 (tender)	(220)	
UU, 12%, due 2012 (tender)	(163)	
LL, 9⅝%, due 1987 (call)	(50)	
85C, 11½%, due 2015 (tender/purchase)	(175)	
RR, 15¾%, due 2011 (call)	(49)	
Pollution Control Revenue Bonds:		
84A, Var. Rate, due 2008 (call)	(196)	
QQP, 10¾%, due 2021 (call)	(8)	
Eurodebentures:		
15%, due 1989 (call)	(76)	
Cumulative Preferred Stock:		
\$100 par, 12.00% (call)	(81)	
\$25 par, 9.20% (call)	(52)	
\$25 par, 8.85% (call)	(52)	
Total Retirements and Redemptions	(1,795)	
Net Capital Raised in 1986		\$ (53)

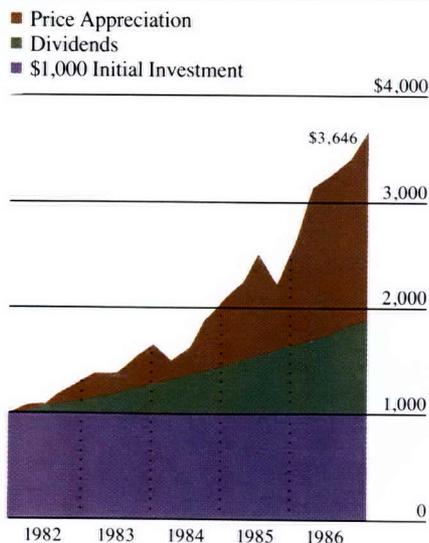
*Includes debt reacquisition expenses, if any.

Weighted Average Cost of Long-Term Debt



A result of Edison's refinancing program was to lower the Company's weighted average cost of debt from the peak of 10.5% in 1983 to 9.1% in 1986, which will save customers over \$70 million annually.

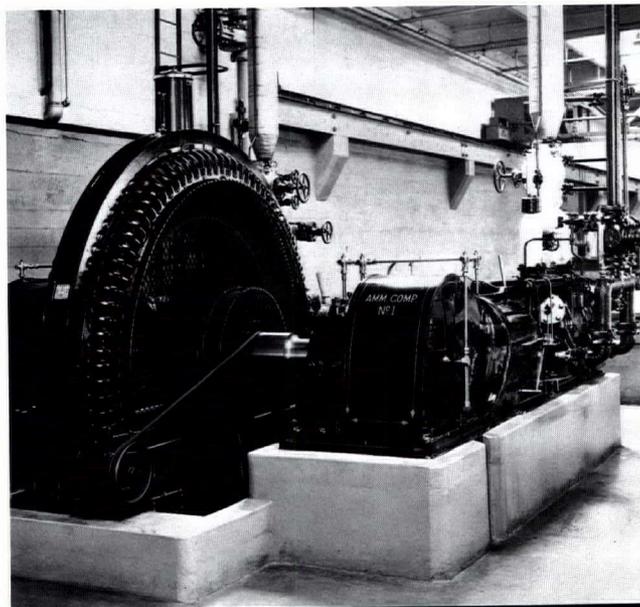
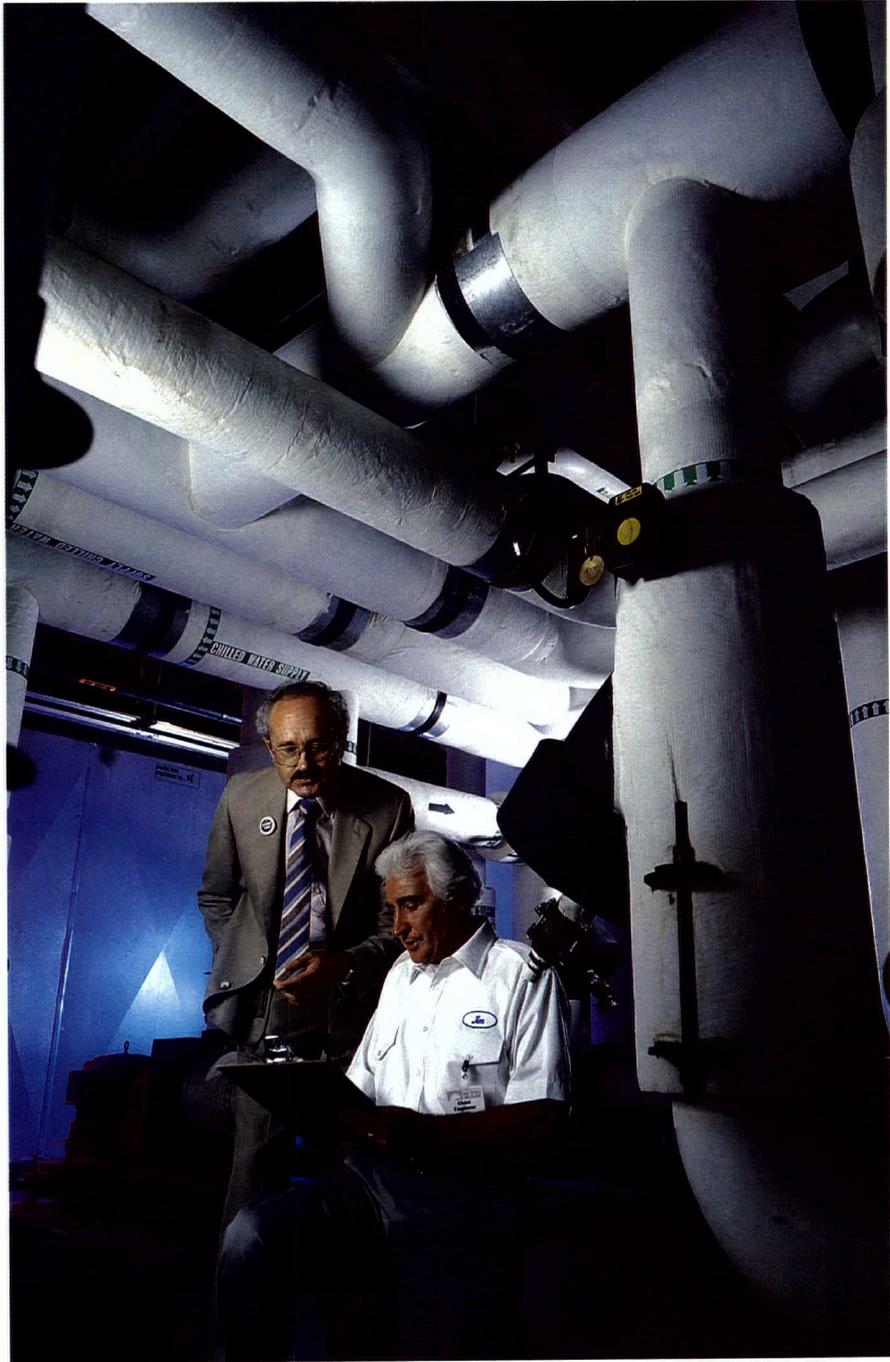
\$1,000 Investment in Edison Common Stock



Through price appreciation and dividends, Edison common stock provided a return to investors of almost 36% in 1986. A \$1,000 investment in Edison common stock at the beginning of 1982 would have grown to \$3,646 by year-end 1986, a compound annual return of 28.5%.

Throughout the 20th Century, Edison employees have been at the forefront of developing new applications of electricity to benefit its customers and communities. At the Orange County Performing Arts Center, Edison energy services representative Douglas Quick discusses the operation of a new, sophisticated air conditioning system with Jim Napier, the Center's chief engineer. Edison has given the Center an energy-efficiency award for a system that freezes water during off-peak periods when electricity is less expensive to generate, creating massive blocks of ice that fill two basement tanks the size of railroad cars, which in turn are used to cool the Center during the heat of the day.

In the early 1900s, Company representatives worked with ice manufacturers to utilize large electric motors to run ammonia compressors, which provided a continuous supply of 25-pound blocks of ice to preserve perishable food and refrigerate fresh produce shipped by rail to distant markets.



Regulatory Review

San Onofre Units 2 and 3 Reasonableness Review

The CPUC's four-year prudence review to determine the reasonableness of the construction and start-up costs for San Onofre Units 2 and 3 resulted in a 3-2 Commission vote to remove \$344.6 million of certain costs of the units from rate base. Edison's share of the disallowance is \$258.6 million.

The Company has asked the CPUC for a rehearing on \$284.3 million of the disallowance—\$185.7 million in alleged licensing delay costs and \$98.6 million in indirect costs. The Company's appeal challenges the disallowance of these items because it is contrary to uncontested evidence in the case.

The Commission's decision was unjust in many respects, including:

- The CPUC's Administrative Law Judge—the one person who heard all 95 days of testimony by 37 witnesses for the Company and 16 witnesses for the Public Staff Division of the CPUC, and read more than 4,300 exhibits and briefs—recommended no disallowance;
- The disallowances are not supported by the record of the case; and
- The San Onofre Units 2 and 3 were built faster and at less cost than other comparable plants in the nation.

(Additional information on the financial implications of this decision is available in Note 2 of "Notes to the Financial Statements" on page 46.)

The CPUC is also reviewing the \$320 million capital investment that the Company has made, or will make, in San Onofre Units 2 and 3 between the units' commercial operating dates and January 1, 1988.

Palo Verde Ratemaking Stipulation

In October, the CPUC approved a stipulation negotiated by its Public Staff Division and Edison to establish ratemaking treatment for the Company's 15.8 percent ownership interest in the three-unit Palo Verde Nuclear Generating Station.

Edison agreed to the stipulation to avoid the protracted hearings and substantial expense that a formal reasonableness review of the Palo Verde construction process might entail. The San Onofre reasonableness review required four years to complete, and the Palo Verde review could be more complicated because four state public utility commissions could be involved.

The stipulation provides that:

- For every dollar of Edison's San Onofre Units 2 and 3 disallowance, 19.3 cents of Palo Verde construction costs are to be disallowed. Based on the CPUC's decision on San Onofre as it now stands, the disallowance for Edison's \$1.5 billion investment in Palo Verde would total \$50 million.
- Palo Verde will be phased into rates over a 10-year period. A portion of the revenue requirement of the investment is being deferred in the first four years, but will be recovered fully, with interest, over the following six years.
- A target capacity factor procedure identical to the one applied to San Onofre Units 2 and 3 will be established for Palo Verde. The procedure provides financial rewards if Palo Verde's capacity factor (a measure of operating efficiency) exceeds 80 percent and assesses penalties if the capacity factor falls below 55 percent during each fuel cycle period.

1987 Attrition Allowance

Effective January 1, 1987, the Company was authorized a \$2.9 million annual revenue increase as an "attrition allowance," which is a change in rates to reflect changes in inflation and capital costs in the years between general rate cases.

1988 General Rate Request

Edison applied to the CPUC on December 26, 1986, for an increase in base revenues of \$265 million annually, or 4.7 percent, effective January 1, 1988. Fuel and purchased power expenses are handled in separate proceedings and are not included in this application. The requested increase is designed to provide an 11.79 percent rate of return on rate base and a rate of return on common equity of 14.75 percent.

The Company also requested an additional \$37 million rate increase effective January 1, 1988, for previously authorized Palo Verde Units 1 and 2 costs. Together these actions, if approved, would increase rates \$302 million, or 5.4 percent, on January 1, 1988.

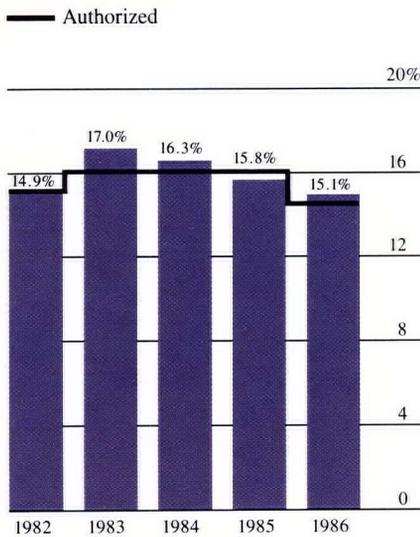
In its application, the Company requested that the Commission approve a new rate design that would more closely reflect the costs of providing service to various classes of customers.

Current rates reflect a long-time CPUC practice of keeping residential rates low, while increasing industrial and commercial rates above the cost of service. As a result, some commercial and industrial customers are finding it cost-effective to install their own electric generation facilities, bypassing the Edison system. The reduction in sales to these customers results in revenue losses which must be absorbed largely by residential, agricultural and smaller commercial customers. Therefore, in its current rate request, the Company is asking the CPUC to increase residential rates and decrease industrial rates in order to protect residential customers from even higher rates in the future.

San Onofre Unit 1 Rate Matters

The Company is seeking to include in rate base \$125 million of capital additions that resulted from seismic design upgrading of San Onofre Unit 1, man-

Rate of Return on Common Equity



In 1986, the Company earned a 15.1% rate of return on common equity. The earned return exceeded the authorized level primarily as a result of favorable coal plant operating performance under an incentive program established by the CPUC. On average Edison has earned its authorized return on common equity over the past five years.

dated by the Nuclear Regulatory Commission, during an outage between February 1982 and November 1984. The Company also is asking the CPUC to determine that \$193.5 million of replacement energy costs that resulted from the outage were incurred reasonably. The CPUC is expected to announce a decision in spring 1987.

In 1980 and 1981, the Company expended \$53 million to repair steam generators at San Onofre Unit 1. In 1986, the CPUC ordered the Company to refund to customers about \$16 million of the \$29 million already collected and to permanently forego collecting the remaining repair costs. The Company will retain \$13 million of the amount already collected, and \$16 million will be refunded through future rate adjustments. Edison filed a lawsuit against Westinghouse Electric Corporation in March 1983 to recover the costs associated with the steam generator repairs. In April 1984, the court dismissed several of the Company's claims, and in January 1987, the court dismissed most of the remaining claims. The Company is currently considering whether to pursue a court appeal.

Energy Cost Rate Matters

The CPUC authorized Edison to collect \$27 million in Energy Cost Adjustment Clause (ECAC) rates as a reward for efficient operation of the Company's coal-fired plants—Mohave Units 1 and 2 in Nevada and Four Corners Generating Station Units 4 and 5 in New Mexico. The CPUC granted this award in 1986 for the plants' 1984 performance, based on the Coal Plant Incentive Program established by the Commission. The CPUC, however, disallowed \$3 million of expenses for research-related fuel oil testing, finding that these expenses would be more suitably recovered through base rates in a general rate case proceeding. Both of these

actions were included in an April 1986 decision on the reasonableness of Edison's 1984 fuel and fuel-related expenses.

During 1986, hearings were held on the reasonableness of Edison's 1985 ECAC operations. A decision is expected in early 1987.

On February 5, 1987, Edison requested a \$111 million annual rate decrease under ECAC, effective June 1, 1987. The projected rate decrease is possible because of lower oil and natural gas prices and increased availability of lower-cost spot market purchased power.

Chevron Settlement

Edison paid Chevron Corporation \$350 million in May 1985 to settle litigation begun in 1982 when the Company terminated an oil supply contract before completion of its 10-year term. As a part of settlement, Chevron agreed to supply oil at market price under a new 10-year standby contract, and Edison agreed to pay Chevron \$9 million per year for the standby service. The early termination and settlement saved Edison customers more than \$1 billion, and the new contract will lower oil inventory costs by providing the Company with a reliable and competitively priced alternative source of oil. Hearings were completed in 1986 on Edison's application to the CPUC to recover the settlement payment over a 2½ year period and to find the standby contract reasonable. A decision is expected in spring 1987.

Revaluation of Fuel Oil Inventory

Edison and the CPUC's Public Staff Division agreed to a stipulation that will resolve the disparity between the price of fuel oil in inventory and the current market value of fuel oil. The stipulation requires Edison to revalue the fuel oil inventory, which was purchased when oil prices were much higher than the current market price.

Edison will recover the approximately \$96.5 million differential through rates, with interest, over a two-year period beginning June 1, 1987. The CPUC approved the stipulation in December 1986, along with similar agreements for the other California electric utilities.

New CPUC Commissioners

Stanley W. Hulett, a San Francisco energy consultant, was appointed by Governor George Deukmejian to the Commission in May to replace William T. Bagley. G. Mitchell Wilk, a special assistant to the governor's chief of staff, was appointed in December to replace Priscilla Grew. Hulett's term expires December 31, 1990; Wilk's term expires December 31, 1992.

In December, Hulett was elected President of the CPUC, succeeding Donald Vial, who will continue to serve as a commissioner and whose term expires December 31, 1988.

The other commissioner is Frederick Duda, who was appointed by Governor Deukmejian in 1984 for a term expiring December 31, 1990.

Victor Calvo, who was appointed to the Commission by former Governor Edmund G. Brown, Jr. in 1981, completed his term on December 31, 1986. Governor Deukmejian is expected to appoint a successor soon.

Legislative Review

Tax Reform Act of 1986

The Tax Reform Act of 1986 significantly changed the nation's tax system. The major impact of this law on Company operations, other than a lower corporate tax rate, will be a modest decrease in internal cash generation resulting from longer depreciation

lives and loss of investment tax credits. The reduced cash flow and the lower corporate tax rate will be reflected in customer rates. The new tax law should have little impact on earnings.

Hydro Relicensing

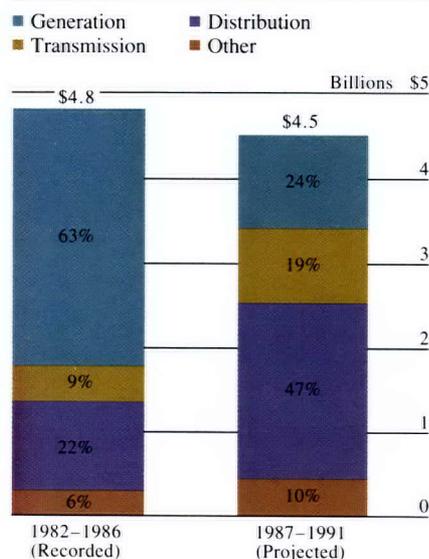
Federal enactment of the Electric Consumers Protection Act of 1986 concluded a successful effort by Edison and other investor-owned utilities to ensure fairness in the federal relicensing of hydroelectric plants. The new law protects the interests of millions of investor-owned utility customers by allowing them to continue to benefit from low-cost hydroelectric power.

The Federal Power Act of 1920 gave preference to municipally owned utilities over investor-owned utilities in licensing the initial development of hydroelectric projects. The Act was unclear as to whether that preference applied to relicensing when original licenses expired. If such a preference were to apply upon relicensing, it would give an unfair advantage to the relatively few municipal utility customers over the millions of investor-owned utility customers who paid for the hydro facilities and who now enjoy the benefits of low-cost hydro power.

The new law establishes that there is no statutory preference given to any applicant, including municipal utilities, when existing hydroelectric facilities are relicensed. Instead, it requires that the Federal Energy Regulatory Commission, when evaluating competing relicense applications, must determine which applicant is best adapted to serve the public interest.

The Company appreciates the support of the shareholders, customers, legislators and regulators who helped achieve the passage of this important consumer protection legislation.

Funds Required for Construction



Edison's construction program over the next five years is estimated to total \$4.5 billion, compared to \$4.8 billion for the past five years. Construction expenditures are projected to shift away from generation plant to the expansion of the Company's transmission and distribution systems.



100 Years of Achievements

The Pioneer Years 1886–1900

On the evening of July 4, 1886, a predecessor of the Southern California Edison Company first provided electricity for street lights in Visalia. Since that important day, generations of dedicated electric utility employees have been working hard to provide an adequate and reliable supply of electric power within the 50,000 square-mile area of Central and Southern California that now comprises Edison's service territory. Located in that area are more than 800 cities and communities, and nearly 10 million people.

While utility workers across the nation faced difficulties during the pioneer years of the electric utility industry, the task of providing electric

service within Southern California was especially challenging. It was a region of rapid growth and change, and a place where even the geography of the land—with its long distances between power plants and population centers, towering mountains and blistering deserts—tested the dedication, daring and creativity of the people working to establish electric service.

In the same year that Edison's first ancestral utility began providing electric service, fierce competition

1887

California's first commercial hydroelectric plant, built by one of a trio of enterprises that comprised Edison's earliest predecessors, begins operation at Highgrove in Riverside County.

between rival railroad companies briefly lowered the fare from St. Louis to Los Angeles to just one dollar. While that amazing fare didn't last long, it provided the impetus for a flow of new settlers into this region that continues to this day.

These new residents demanded the same quality of life they had enjoyed

1892

Transformers are first used to raise generator output voltage for long-distance transmission of energy out of the San Antonio or "Pomona" Hydroelectric Plant.

in the East, especially those "new-fangled" electric lights. In addition to Visalia's utility, other predecessor companies of Edison were organized in Santa Barbara and at Highgrove, in Riverside County, in 1886 (though they did not deliver electricity until the following year).



Mrs. Colby, in white, and her assistant came to Edison from General Electric to demonstrate early electric cooking appliances.

More than 2,000 real estate agents were registered in Los Angeles County in 1888 and it's not too surprising that 60 communities and towns sprung up in the greater Los Angeles area that year. Coupled with the convenient travel offered by the new transcontinental railroad systems, a serious blizzard in the East in March of 1888 made California's sunshine seem especially attractive. As still



Visalia celebrates the Fourth of July, 1886. Notice a glass globe, part of the community's pioneer electric street light system, hanging over the street in upper left corner.



Skilled workmen install the last segment of penstock pipe at Big Creek No. 1. When completed, the pipeline had the longest and steepest drop from reservoir to water wheel of any powerhouse in the world.

occurs today, many of the Easterners who planned only to vacation on the sunny Pacific Coast stayed and became new residents.

The population of Los Angeles and Orange Counties was 33,400 in 1880. This increased more than five times over to 190,000 in just 10 years. During the 1890s, electric companies were formed in many communities to meet customer demand for a service that quickly became a necessity of life.

During the 1890s, Southern California's oil industry boomed, and the potential for jobs and wealth from "black gold" lured thousands of



Edison customer services included free replacement of burned-out light bulbs by the delivery boys of the Lamp Department. This service was important in the days prior to the widespread use of the modern standard screw-base light bulb.

1899

Edison's Santa Ana River No. 1 Hydro Plant begins operation, transmitting power into Los Angeles over the nation's longest (83 miles) power line.

people to the area. In 1895, the region's annual oil output reached one million barrels.

In this time period, farmers began to benefit from electric water pumping, making irrigation of crops easier. In 1894, the Redlands Electric Light and Power Company, a predecessor of Southern California Edison, became the first utility to offer farmers electric pumping. The Redlands utility was able to do this because in 1893 it began operating its Mill Creek No. 1 hydroelectric plant, the nation's first three-phase alternating current power plant. This new generating technology could operate motors better and more efficiently, and it was eventually adopted by utilities throughout the United States.

In 1897, the Edison Electric Company, Southern California Edison's direct predecessor, began operations in Los Angeles.

Consolidation 1901-1919

During the first decade of the Twentieth Century, the original pioneer electric companies were consolidated into larger regional systems. This amalgamation of electric companies resulted in more reliable and lower cost electric service to Southern California communities.

Under the direction of its president, John B. Miller, the Edison Electric Company of Los Angeles quickly expanded. The utility eventually provided power to communities as far south as Santa Ana, north to Santa Barbara and east to Redlands. To reflect this expansion, the Company's name was changed to Southern California Edison and it was reincorporated on July 6, 1909.

Employees of Edison and other electric utilities continued to build new power plants and expand their



Dining At Home

is made more enjoyable when the room is brilliantly lighted by the rays of the new Edison Mazda Lamp. The best substitute for sunlight in the home yet produced is obtained by the use of this latest improvement in electric lighting.

The noteworthy feature of the new Edison Mazda is its durability and strength to withstand all ordinary handling.

Come in to-day and let us show you the merits of this new lamp.

SOUTHERN CALIFORNIA EDISON COMPANY.

services to meet the Southland's growing need for electricity for street lights, trolley lines, homes and businesses. In 1907, Edison Electric Company workers set a world record for long distance power line construction

with a 118-mile line to Los Angeles from a Kern River hydroelectric plant. That line was also the first to be supported entirely on steel towers.

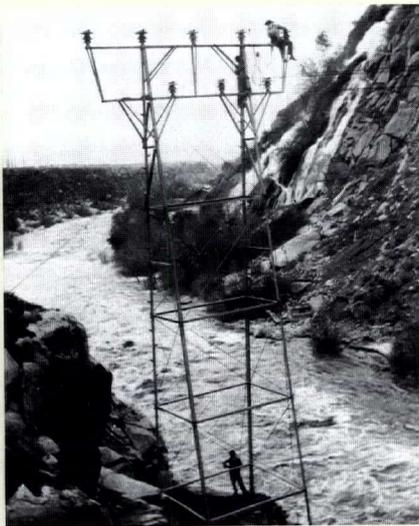
The Southland's businesses and industries continued to grow rapidly. California became the nation's leading oil producing state in 1900, with the output concentrated mainly in Southern California. San Pedro Harbor operations increased following a ten-year expansion program completed in 1903. That year President Theodore Roosevelt also signed the Panama Canal Treaty, which paved



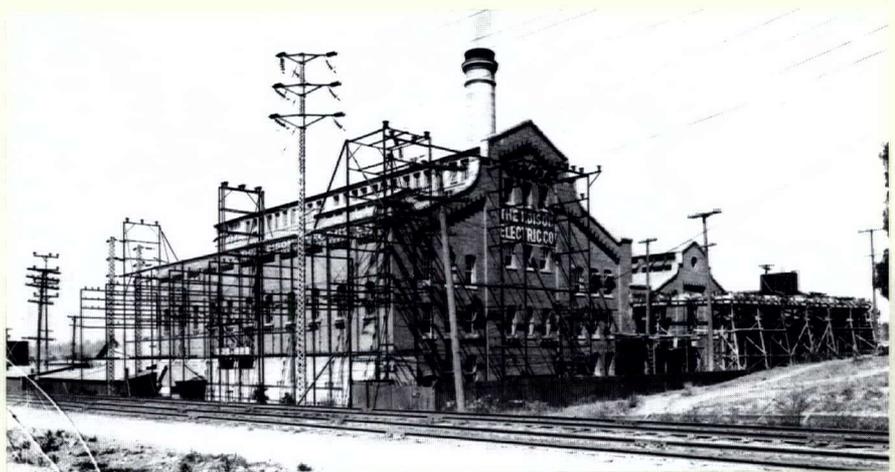
During Electrical Prosperity Week in 1915 the Company fitted out an electric wagon with this display of electric appliances.

the way for construction of a project that would dramatically increase activity at California ports.

In 1901, the Pacific Electric Railway was established by Henry E. Huntington to provide trolley service in the greater Los Angeles area. The trolley service and Mr. Huntington's



Linemen work on one of the historic Kern River 75,000-volt transmission line towers.



Los Angeles No. 3 Steam Plant was the nerve center of the Edison system in 1912.

other business enterprises did much to foster growth in Southern California.

Mr. Huntington's business ventures included electric, water and gas utilities in addition to electric railways. He helped to establish the Pacific Light and Power Company in 1902 in order to build power plants to assure adequate electric power for his trolley operations.

The aerospace industry of Southern California began in 1906 when aviation pioneer Glenn Curtiss built a commercial aircraft at his manufacturing facility in Santa Ana. A few years

1907

Edison's Kern River-Los Angeles Transmission Line is placed into operation, the nation's longest (118 miles) and highest voltage (75 KV) power line. It is the first line in the nation entirely supported on steel towers for its entire length.

later, Donald Douglas started manufacturing aircraft in Santa Monica, and he built the first planes to fly around the world. His aircraft gave the United States a decided strategic advantage when the nation entered World War I in 1917.

By 1910 another major industry was forming in Hollywood as early movie makers began operations that would soon have a significant impact on entertainment the world over. Edison's

lighting engineers developed flood-lighting systems to enable movie directors to use indoor studios for filming.

During this period, electricity usage also was increasing rapidly in the farming areas of Central California. The Mount Whitney Power Company, a predecessor of Southern California Edison established in 1899, sold most



Raising a power pole in 1912 required a lot of muscle power.

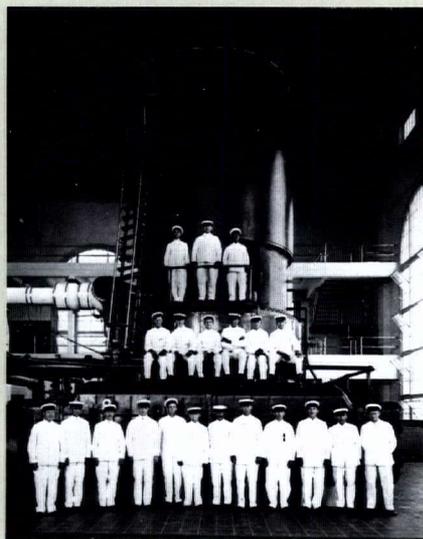
of its power to farmers in the San Joaquin Valley for crop irrigation. That utility built power plants along the Kaweah and Tule Rivers to enable the region's farmers to benefit from low-cost hydroelectric generation.

Another predecessor company of Edison, the Nevada Power, Mining and Milling Company, was organized

in 1904 and immediately began construction of hydroelectric plants along Bishop Creek. This company provided power for the mining operations in the Nevada towns of Tonopah and Goldfield, as well as to other mining camps along the California-Nevada border.

Although most of those mining towns eventually became ghost towns, the hydroelectric plants still operate today. As mining operations closed down, the power from those hydroelectric plants at Bishop Creek was sold in various communities not already served by electric companies.

The Southland's continued growth led to demands for more electricity, and also for more plentiful water supplies. The area's low annual rainfall



Long Beach Steam Plant's operators in their white naval-style uniforms stand before Unit No. 1 on its first day of operation.

was insufficient to meet the water needs of the growing numbers of homes and businesses, while still providing enough water for farmlands.

An unusually dry weather cycle at the turn of the century endangered farmers' wheat crops and focused the public's attention on the possibility of serious water shortages. After much public discussion, Los Angeles voters approved a multi-million-dollar proj-

ect to build a massive 250-mile-long gravity-flow aqueduct to bring water to Los Angeles from the Owens Valley. The aqueduct was completed

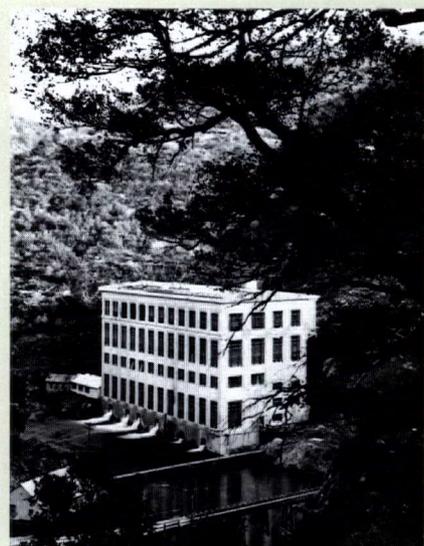
1913

Edison predecessor, the Pacific Light and Power Corporation, energizes Big Creek Power House No. 1 and the Big Creek-Eagle Rock Transmission line, marking the initial startup of the nation's largest hydroelectric project.

in 1913 and immediately spurred new growth in the Los Angeles area.

Also in 1913, Huntington's Pacific Light and Power Company finished the construction of Big Creek Power Houses No. 1 and No. 2. The abundant water resources of the Sierra Nevada mountain range thus began producing power for Central and Southern California. Since that time, Big Creek facilities have been expanded to provide as much low-cost hydro power to customers as possible.

The development of Big Creek was a challenging effort. Huntington had to build a railroad, the San Joaquin and Eastern, in order to haul supplies and men to the remote area of Big Creek. That feat was accomplished in July 1912, less than six months after work began, even though Huntington had none of the bulldozers and other modern earthmoving equipment used today.

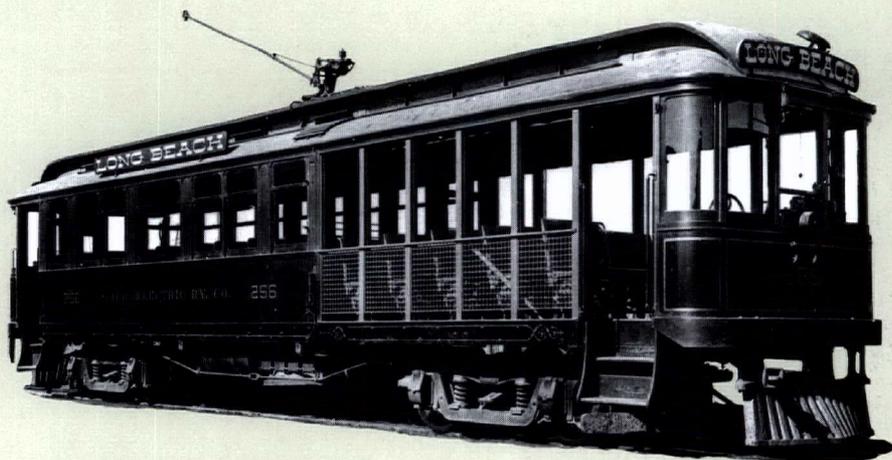


Big Creek No. 2 plant, photographed in 1917 just before construction of additional units began.

Difficult Decades 1920-1940

Humorist Will Rogers was popular throughout the nation in the 1920s. But he was especially popular in Southern California, where he lived. Rogers provided comic relief to California residents and others throughout the nation who were facing serious difficulties in the years before and during The Great Depression.

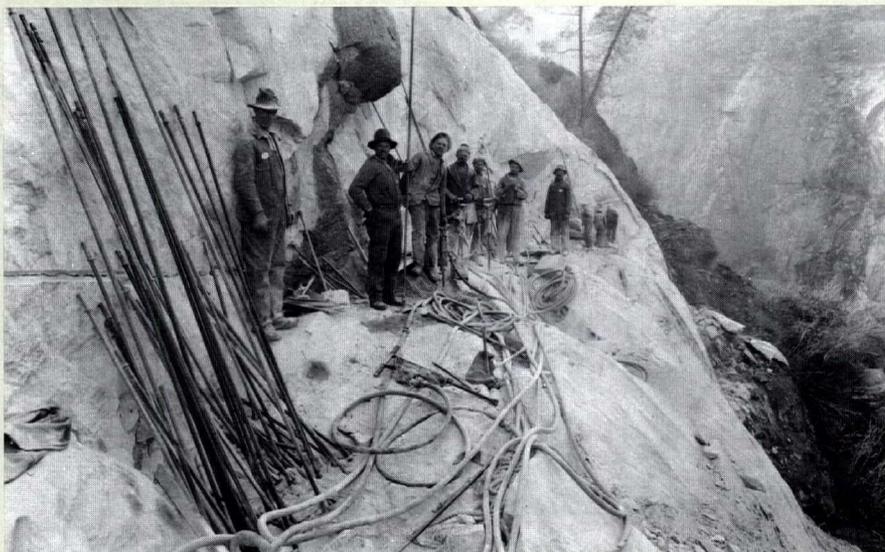
In 1923 and 1924, a drought caused economic problems for farmers and for electric utilities and their customers, since Edison relied almost en-



Pacific Electric's "Big Red Cars" introduced rapid transit to Southern California and provided reliable transportation to millions of Southlanders for more than 50 years.

tirely on hydroelectric power plants for electricity. In the latter part of the 1920s, the Company expanded its steam generating plant at Long Beach to prevent future problems due to water shortages.

Major earthquakes struck Southern California in 1925 and 1933, destroying homes, businesses and one power plant. Many Edison employees volunteered to help with relief efforts, and the Company donated supplies to Red Cross food stations.



In 1922, during the expansion of the Big Creek project, workmen carved the "Million Dollar Mile" section of road through granite along the precipitous gorge of the San Joaquin River.

Another catastrophe occurred with the collapse of the City of Los Angeles' St. Francis Dam, 45 miles northwest of Los Angeles, which led to extensive flooding. As soon as an Edison line patrolman notified Edison Dispatcher J. D. Poe of the dam's collapse at a few minutes after midnight on March 13, 1928, Poe immediately phoned warnings to communities in the path of the raging floodwaters. Poe's quick thinking was credited with saving many lives.



Display installer stands beside the Display Department's truck in 1929.

One of the few causes for celebration during this period was the completion of the magnificent Hoover Dam in 1936, which is still today regarded as one of the largest and most successful engineering marvels in the world.

The Edison Electric Company had considered building hydroelectric facilities on the Colorado River as early as 1902, but transmission of power would have been difficult and costly, and those plans were shelved. In 1921,



Hoover Dam, envisioned by engineers in 1930, became a reality in 1936.

Edison's proposals to build its own facilities, a compromise was reached in 1930 that designated Edison as the utility that would operate some of Hoover Dam's generators for itself and other investor-owned utilities. The same compromise allowed the Los Angeles Department of Water and Power to generate power for the participating states, municipal utilities and the Metropolitan Water District.

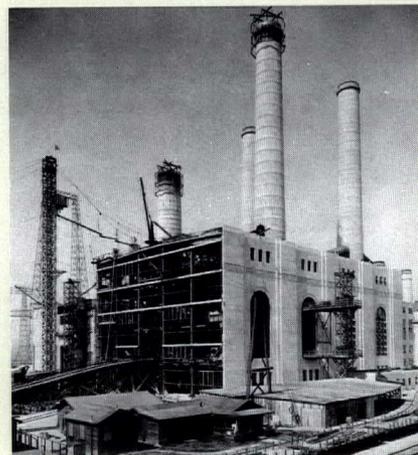
In 1931, a \$49 million contract was approved, and construction began on the world's highest dam—726 feet—that would create the world's largest manmade lake. The project was completed in October 1936, and nearly a million residents of the Los Angeles area crowded downtown streets to view the first delivery of electricity from Hoover Dam. Today, this project

1927

Edison predecessor, the Southern Sierras Power Company, drills the first geothermal power production well in the United States.

Edison, in cooperation with the U.S. Geological Survey, sent surveyors to select potential sites for hydroelectric plants along the Colorado River. Edison officials were pleased with the results and filed federal applications to build dams and generating facilities at several locations.

But several utilities and agencies wanted to be involved in developing power resources along the Colorado River. After much debate in Congress, the Boulder Canyon Act of 1928 passed. Although it ruled out



Work on the Long Beach Steam Plant No. 3 continued despite the Great Depression as the Company sought to keep its workforce employed.

continues to provide power to the customers of Edison and other utilities.

During this period of history, the decades of the 1920s and 1930s, the service territories of Southern California utilities changed. In May 1922, the Edison Company completed the transfer of distribution facilities within the City of Los Angeles to that city's Bureau of Power and Light, which today is known as the Los Angeles Department of Water and Power.

In August 1939, Edison and the City of Los Angeles exchanged additional distribution facilities. The city,



Edison's "Fifth and Grand" General Office building opened its doors in 1931.

which had purchased the Los Angeles Gas and Electric Corporation in early 1937, gave to Edison facilities outside of the city limits that formerly belonged to L.A. Gas and Electric. In return, Edison gave to the city distribution facilities in areas that had been annexed by Los Angeles since the original sales agreement between Edison and the city in 1922.



"Busy Buttons" was the symbol of Edison service in the Twenties and Thirties.



Southern California became the nation's fastest growing area at the end of WW II.

War and Postwar 1941–1960

On December 7, 1941, Japanese war planes bombed Pearl Harbor. The U.S. now was at war with Japan, Germany and Italy. Business and industry all across the nation focused efforts on aiding the war effort.

In Southern California, individuals and companies such as Southern California Edison participated in scrap drives to collect copper, iron, steel, brass and rubber for war materials. People learned to live with less and supported government food and gas rationing programs. Edison also taught its customers how to "light-proof" their homes to comply with blackout regulations.

In one of the more unusual events in Edison's history, Soviet Union officials visited Edison's Long Beach Steam Plant to coordinate the dismantling of a generating unit. The federal government officially seized the unit and ordered Edison to turn it over to the Soviet Union, a U.S. ally during the war.

The U.S. and its allies prevailed. Germany surrendered in May 1945. Three months later, after atomic bombs fell on Hiroshima and Nagasaki, Japan also surrendered.

Suburbs sprouted up across the country as returning U.S. troops started families and used GI loans to buy homes. Many of the veterans who had trained at California military bases relocated their families to this state, again boosting the Southland's population.

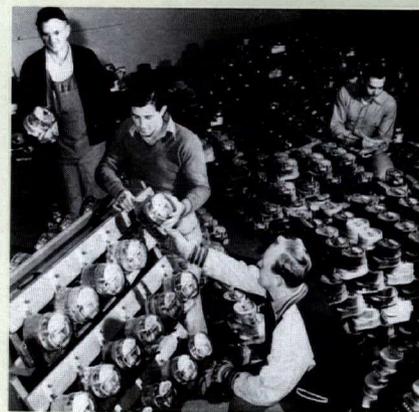
Edison and other utilities across the country began building massive new power plants to meet growing elec-

tricity needs during this so-called "postwar baby boom." These new large-scale generating plants also helped to lower electricity prices because of economies of scale. Electricity was plentiful, and appliance manufacturers continued to introduce new products for the home.

1947

Edison begins a research project to control visible emissions and sulfur dioxide at its steam plants. This voluntary effort was the first research program of its kind in the industry.

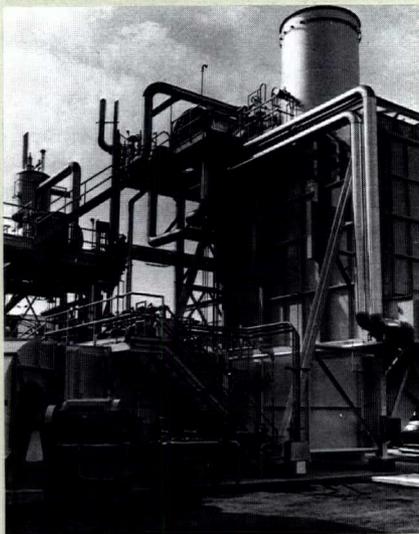
Edison's generating capacity soared from one million kilowatts at the end of World War II to nearly seven million kilowatts in 1965. Although oil and gas-fired steam plants accounted for the bulk of this new generating capacity, Edison also doubled the output of its Big Creek hydroelectric facilities between the end of World War II and 1960.



Edison converted its system from 50 to 60-cycle operation during the 1946–48 period, which involved rebuilding every customer meter.

The Modern Era 1960–1986

In California, the 1960s was a decade of dramatic growth. In 1962, California surpassed New York as the most populous state. On December 31, 1963, California Electric Power Co., which served some 450,000 people in a 41,500 square-mile service territory, merged with Edison.



This boiler at the Garden State Paper Company was Edison's first industrial cogeneration installation in modern times.

Southern California Edison continued to expand its facilities to meet the increasing demands for electricity by its customers and turned to nuclear power to meet some of that increasing demand. In 1963 the Company began

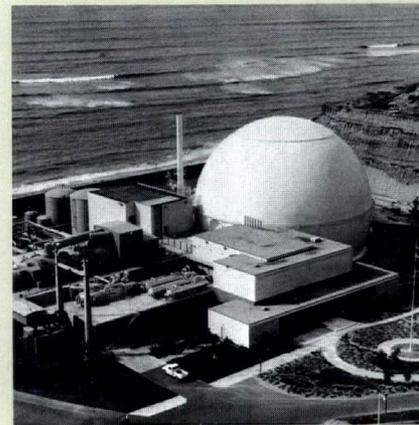
construction of the San Onofre Nuclear Generating Station. That first San Onofre unit was dedicated in January 1968. Units 2 and 3 went into operation in 1983 and 1984, respectively.

In 1967, the Company completed the construction of a major transmission link with the Pacific Northwest, enabling customers to benefit from the purchase of low-cost surplus hydroelectric power from the federally owned Bonneville Power Administration. A second transmission link to the Pacific Northwest was completed in 1970 as a joint project with the Los Angeles Department of Water and Power. At the time it was the highest capacity and longest direct current transmission line in the world.

Electric utilities have faced dramatic changes in recent years, including increased public concern for the environment, a more unstable world energy market, a shift away from the construction of large-scale power plants, development of alternative and renewable energy resources, and a changing business environment.

Southern California Edison has responded well to these changes and is recognized as one of the most successful and innovative electric utility companies in the world.

Edison began environmental studies related to air quality in the late 1940s and has implemented a variety of environmental programs since that time. For example, California's largest arti-



San Onofre nuclear unit No. 1 entered operation in 1968.

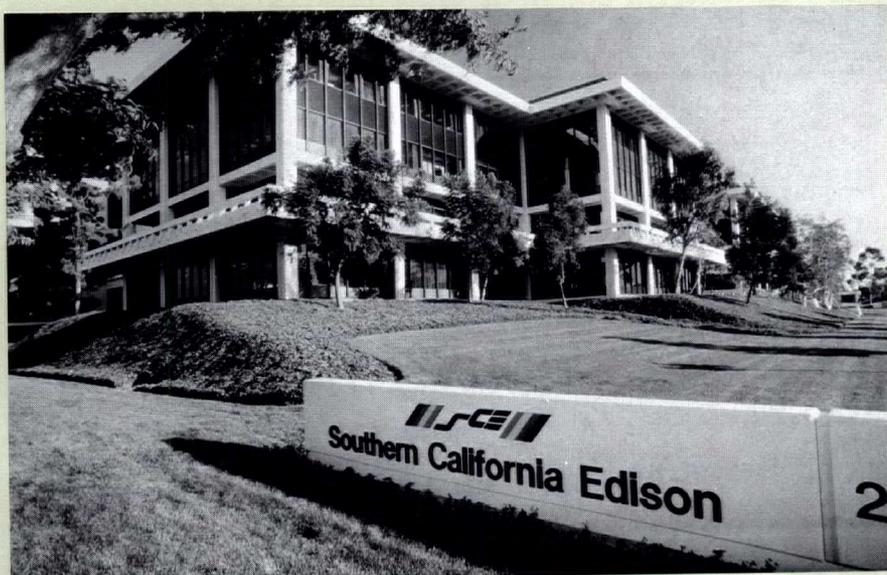
ficial ocean reef, designed to enhance marine life, was constructed off the California coast as a joint venture between Edison and the California Department of Fish and Game.

Another of Edison's many environmental projects involves the successful use of by-product heat from coastal generating stations to cultivate lobsters and abalone. The warm water accelerates their growth. Edison has provided thousands of juvenile abalone to the California Fish and Game for placement in ocean waters.

World energy supplies were plenti-

1970

Edison and the Los Angeles Department of Water and Power jointly dedicate an 846-mile long, 800-KV direct current transmission line extending from near Portland, Oregon, to Sylmar, near Los Angeles. This was the highest capacity and longest distance DC transmission line in the world, and the first extra-high-voltage DC line built in the United States.



The current Rosemead General Office was completed and occupied in 1971.

ful and prices stable for the period extending from the end of World War II until 1973, when the oil embargo dramatically increased the price of oil, a primary fuel for generating plants. Edison responded to the volatile changes in the world oil markets by promoting conservation and developing a wide range of energy resources.

Since the 1973 oil embargo, Edison and other utilities have encouraged customers to practice energy conser-

vation and load management (“give your appliances the afternoon off”). Edison developed a number of conser-

1980

Edison is the first electric utility in the nation to make a large-scale commitment to the development of renewable and alternate energy resources.

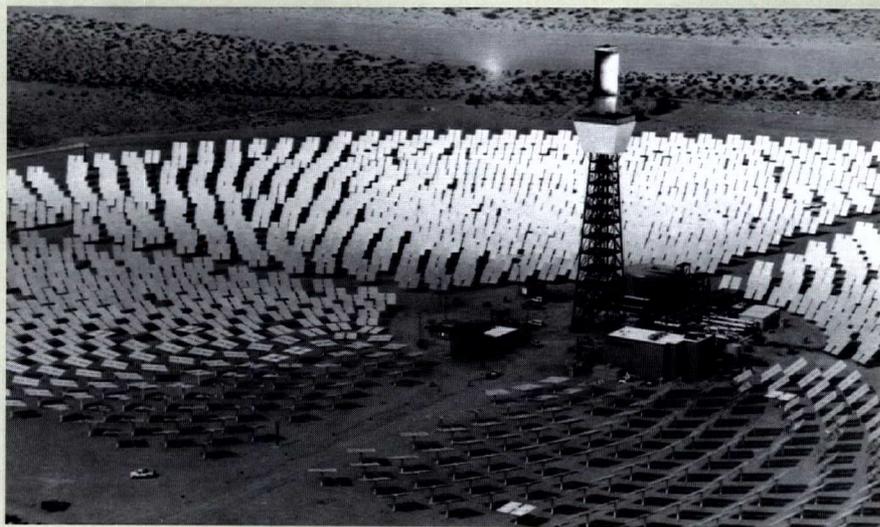
vation programs to help residential and business customers reduce their energy consumption. These programs help to make maximum use of existing resources and reduce the need for building new generating facilities.

Although Edison was involved in several alternative and renewable energy projects before October 1980, during that month the Company publicly made a large-scale commitment to develop renewable and alternate energy resources. Today, Edison provides electricity to its customers from nine different energy resources, more than any other electric utility in the world.



Edison introduced a new company logo and uniform in 1984.

In 1982, Southern California Edison won the prestigious Thomas A. Edison Award from the Edison Electric Institute, an association of electric utilities throughout the United States. Edison has received EEI's top honor four times since the award was established in 1922, more times than any other utility. Edison won the award that first year, 1922, and again in 1944, 1963 and 1982.



Solar One, the nation's first commercial solar-thermal power plant, produced its first power in 1982.

To take advantage of business opportunities beyond the traditional utility area, Edison established four non-utility subsidiaries in 1986. The subsidiaries are Mission Energy Company, which is involved in cogeneration and alternate energy projects; Mission Land Company, which is involved in commercial land development; Mission Power Engineering Company, which provides energy en-

1983

Edison obtains electric power from nine primary energy resources—water, oil, natural gas, uranium, coal, geothermal, wind, solar and biomass—more resources than any other electric utility in world.

gineering and construction services; and Mission Financial Management Company, which will engage in financial investments.

Edison and its employees have responded well to the dramatic changes of recent years. Their combined efforts have enabled the Company to gain recognition for innovation within the electric utility industry, and for being a good corporate citizen in the communities it serves.

Edison's long-standing motto of “Good Service, Square Dealing, Courteous Treatment” was first stated

1984

Edison and Texaco, Inc., jointly place into operation the world's first commercial-scale coal gasification plant that converts coal into a clean burning gas to produce electricity.

by the Company's president, John B. Miller, in 1905. That motto has not changed. The people of Edison provide more than reliable electric service at a reasonable cost. They help the communities in which they work and live; they have a genuine concern for the environment; they are committed to providing quality service to customers; and their success over the years has benefitted shareholders by enabling them to earn a fair return on their investment.



The Southern California Edison Company has won the prestigious Thomas A. Edison Award more times than any other utility. The gold medals for the 1982 award (left) and the 1963 award (center) are displayed next to the Charles A. Coffin Medal won in 1922. The 1944 Award was a certificate rather than a medal because of war-time shortages.

Responsibility for Financial Statements

The management of Southern California Edison Company is responsible for the information and representations contained in the financial statements and the related financial information presented in this report. The financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and include amounts based on judgments and estimates of management.

The Company maintains internal accounting control systems and related policies and procedures designed to provide reasonable assurance that assets are safeguarded, that transactions are executed in accordance with management's authorization and properly recorded, and that accounting records may be relied upon for the preparation of financial statements and other financial information. The design of internal accounting control systems involves management's judgment concerning the relative cost and expected benefits of specific control measures. These systems are augmented by programs of internal audits through which the adequacy and effectiveness of internal accounting controls, policies, and procedures are evaluated and reported to management.

The Company's financial statements have been examined in accordance with generally accepted auditing standards by independent public accountants who have expressed their opinion with respect to the fairness of these statements.

The Audit Committee of the Board of Directors, composed entirely of non-employee directors, meets periodically with the independent public accountants, internal auditors and management. This Committee, which recommends the annual appointment of the independent public accountants, also considers the audit scope and nature of other services provided, discusses the adequacy of internal accounting controls, reviews financial and reporting issues and is advised of management actions on these matters. Both the independent public accountants and the internal auditors have full and free access to the Audit Committee.

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, 1986 and 1985 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, 1986. 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) has issued a decision dated October 29, 1986 in connection with its review of \$3.4 billion of the Company's investment in San Onofre Nuclear Generating Station Units 2 and 3. This decision ordered that \$258.6 million of the Company's investment should be disallowed. In addition, as a result of a stipulation agreed to by the Company and adopted by the CPUC on October 1, 1986, \$50 million of the Company's investment in Palo Verde Nuclear Generating Station Units 1, 2 and 3 would be disallowed based on the above CPUC decision. The Company has appealed \$254.6 million of the San Onofre and stipulated Palo Verde disallowances by filing an application for rehearing with the CPUC. It is not possible for the Company to determine the probable financial effect that the final outcome of the CPUC proceedings in this matter will have on the Company's financial position and results of operations.

In our opinion, subject to the effects 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, 1986 and 1985 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, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.

Arthur Andersen & Co.

Los Angeles, California,
February 11, 1987.

ARTHUR ANDERSEN & CO.

Statements of Income

	Year Ended December 31,	1986	1985	1984
			<i>(In Thousands)</i>	
Operating Revenues:				
Sales (Notes 1 and 2)		\$5,275,547	\$5,141,735	\$4,842,959
Other		36,186	27,113	56,193
Total operating revenues		<u>5,311,733</u>	<u>5,168,848</u>	<u>4,899,152</u>
Operating Expenses:				
Fuel (Notes 1 and 2)		878,040	1,683,363	1,478,236
Purchased power (Note 8)		775,814	705,724	606,705
Provisions for regulatory adjustment clauses—net (Note 1)		168,812	(607,036)	(460,337)
Other operating expenses (Note 8)		809,000	755,325	728,625
Maintenance		352,696	352,635	419,458
Depreciation (Note 1)		504,701	454,574	398,623
Income taxes (Note 4)		711,493	720,938	639,875
Property and other taxes		143,274	130,571	121,342
Total operating expenses		<u>4,343,830</u>	<u>4,196,094</u>	<u>3,932,527</u>
Operating Income		<u>967,903</u>	<u>972,754</u>	<u>966,625</u>
Other Income:				
Allowance for equity funds used during construction (Note 1)		105,744	123,179	145,967
Interest income		96,533	83,867	67,601
Taxes on non-operating income—credit (Note 4)		10,743	11,928	29,666
Other income and income deductions—net		41,071	35,664	4,071
Total other income		<u>254,091</u>	<u>254,638</u>	<u>247,305</u>
Total Income Before Interest Charges		<u>1,221,994</u>	<u>1,227,392</u>	<u>1,213,930</u>
Interest Charges:				
Interest on long-term debt and amortization (Note 1)		432,608	426,783	449,834
Other interest charges		50,247	61,017	80,488
Total interest charges		482,855	487,800	530,322
Allowance for borrowed funds used during construction (Note 1)		(29,478)	(34,515)	(48,820)
Net interest charges		<u>453,377</u>	<u>453,285</u>	<u>481,502</u>
Net Income		<u>768,617</u>	<u>774,107</u>	<u>732,428</u>
Dividends on Cumulative Preferred and Preference Stock		54,684	71,698	73,043
Earnings Available for Common and Original Preferred Stock		<u>\$ 713,933</u>	<u>\$ 702,409</u>	<u>\$ 659,385</u>
Weighted-Average Shares of Common and Original Preferred Stock Outstanding (000)		217,732	215,649	207,576
Earnings Per Share		<u>\$3.28</u>	\$3.26	\$3.18
Dividends Declared Per Common Share		<u>\$2.25</u>	\$2.13	\$2.01

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

Balance Sheets

Assets	At December 31,	1986	1985
		<i>(In Thousands)</i>	
Utility Plant:			
Utility plant, at original cost <i>(Notes 1, 2 and 6)</i>		\$13,676,746	\$11,853,442
Less—Accumulated depreciation <i>(Notes 1 and 6)</i>		3,586,080	3,152,141
		10,090,666	8,701,301
Construction work in progress <i>(Notes 1 and 6)</i>		1,342,169	2,041,738
Nuclear fuel, at amortized cost		95,627	95,180
		11,528,462	10,838,219
Less—Property-related accumulated deferred income taxes <i>(Notes 1 and 4)</i>		708,436	531,746
Total utility plant		10,820,026	10,306,473
Other Property and Investments:			
Non-utility property and other investments, at cost—less accumulated depreciation . .		45,546	38,501
Special funds <i>(Note 1)</i>		—	24,326
Investments in and advances to subsidiaries <i>(Note 1)</i>		207,282	162,786
Total other property and investments		252,828	225,613
Current Assets:			
Cash and equivalents <i>(Note 3)</i>		33,603	37,757
Cash investments—financing subsidiary <i>(Note 1)</i>		65,545	163,979
Receivables, less reserves of \$11,874,000 and \$9,833,000 for uncollectible accounts at respective dates		364,396	351,095
Fuel stock, at cost (first-in, first-out) <i>(Note 1)</i>		233,528	255,508
Materials and supplies, at average cost		123,480	106,178
Regulatory balancing accounts—net <i>(Notes 1 and 2)</i>		739,050	792,011
Prepayments and other		72,808	100,663
Total current assets		1,632,410	1,807,191
Deferred Charges:			
Unamortized debt issuance and reacquisition expense <i>(Note 1)</i>		303,599	144,977
Rate phase-in plan <i>(Note 2)</i>		90,650	—
Other deferred charges <i>(Note 8)</i>		145,439	109,195
Total deferred charges		539,688	254,172
Total Assets		\$13,244,952	\$12,593,449

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

Capitalization and Liabilities	At December 31,	1986	1985
		<i>(In Thousands)</i>	
Capitalization:			
Common stock, at par value, 216,906,527 and 216,676,897 shares outstanding at respective dates		\$ 903,777	\$ 902,821
Additional paid-in capital		1,546,541	1,543,933
Earnings reinvested in the business		<u>2,343,957</u>	<u>2,128,646</u>
Common shareholders' equity		4,794,275	4,575,400
Preferred and preference stock without mandatory redemption requirements		365,654	466,500
Preferred and preference stock with mandatory redemption requirements		299,049	395,074
Long-term debt		<u>4,667,891</u>	<u>4,717,411</u>
Total capitalization		<u>10,126,869</u>	<u>10,154,385</u>
Long-term Obligations:			
Accumulated provisions for pensions, insurance and other (Note 5)		<u>95,680</u>	<u>91,126</u>
Current Liabilities:			
Preferred and preference stock to be redeemed within one year		18,213	20,463
Long-term debt due within one year		103,315	45,110
Short-term borrowings (Note 3)		328,000	15,000
Short-term borrowings—financing subsidiary (Notes 1 and 3)		48,800	148,850
Accounts payable		415,118	401,489
Accrued taxes (Note 4)		460,171	233,722
Accrued interest		109,034	110,394
Dividends payable		127,783	122,347
Accumulated deferred income taxes—net (Note 4)		340,952	391,781
Other		<u>134,174</u>	<u>106,240</u>
Total current liabilities		<u>2,085,560</u>	<u>1,595,396</u>
Deferred Credits:			
Accumulated deferred investment tax credits (Note 4)		544,866	485,614
Accumulated deferred income taxes—net (Note 4)		121,943	32,062
Customer advances and other deferred credits		<u>270,034</u>	<u>234,866</u>
Total deferred credits		<u>936,843</u>	<u>752,542</u>
Commitments and Contingencies (Notes 2, 7, 8 and 9)			
Total Capitalization and Liabilities		<u>\$13,244,952</u>	<u>\$12,593,449</u>

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

Statements of Sources of Funds Used for Construction Expenditures

	Year Ended December 31,	1986	1985	1984
		<i>(In Thousands)</i>		
FUNDS PROVIDED BY—				
Operations:				
Net income		\$ 768,617	\$ 774,107	\$ 732,428
Items in net income not affecting working capital—				
Depreciation		504,701	454,574	398,623
Allowance for equity and borrowed funds used during construction		(135,222)	(157,694)	(194,787)
Rate phase-in plan		(90,650)	—	—
Deferred income taxes		266,571	192,575	174,496
Deferred investment tax credits—net		59,252	84,134	55,323
Other—net		19,894	5,102	40,408
Total funds provided by operations		<u>1,393,163</u>	<u>1,352,798</u>	<u>1,206,491</u>
Dividends		(544,282)	(532,265)	(492,049)
Total funds provided by operations—reinvested		<u>848,881</u>	<u>820,533</u>	<u>714,442</u>
Long-term Financing:				
Sales of securities—				
Common stock		3,504	90,770	209,321
Long-term debt		1,427,026	1,111,880	627,860
Reduction for preferred and preference stock to be redeemed within one year		(18,213)	(20,463)	(18,213)
Conversion of preference stock		(845)	(758)	(1,764)
Increase in other long-term debt		—	—	2,638
Reduction for long-term debt due within one year		(103,315)	(45,110)	(101,250)
Refunding and early retirement of preferred stock and long-term debt—net		(1,730,888)	(653,632)	(403,896)
Total funds provided by (used for) long-term financing		<u>(422,731)</u>	<u>482,687</u>	<u>314,696</u>
Total funds provided		<u>426,150</u>	<u>1,303,220</u>	<u>1,029,138</u>
OTHER SOURCES (USES) OF FUNDS—				
Working capital changes:				
Cash and equivalents and cash investments		102,588	20,268	189,669
Receivables—net		(13,301)	20,455	(70,859)
Fuel stock, materials and supplies		4,678	154,659	5,835
Accumulated deferred income taxes—net		(50,829)	392,808	216,663
Preferred and preference stock and long-term debt due within one year ..		55,955	(53,890)	31,963
Short-term borrowings		212,950	21,900	(56,020)
Accounts payable		13,629	6,005	31,028
Accrued taxes		226,449	(2,653)	(71,028)
Regulatory balancing accounts—net		52,961	(773,656)	(394,603)
Other changes in working capital		59,865	19,658	(9,910)
Net (increase) decrease in working capital		664,945	(194,446)	(127,262)
Fuel contract settlement payments, net of deferred taxes		—	(62,402)	—
Special funds and other—net		(1,418)	30,123	(49,602)
Total other sources (uses) of funds		<u>663,527</u>	<u>(226,725)</u>	<u>(176,864)</u>
Funds Used for Construction Expenditures		<u>\$1,089,677</u>	<u>\$1,076,495</u>	<u>\$ 852,274</u>

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

Statements of Capitalization

	December 31, 1986		December 31,	
	Shares Outstanding	Redemption Price	1986	1985
<i>(In Thousands)</i>				
Common Shareholders' Equity —detailed on page 42.	216,906,527	—	\$ 4,794,275	\$ 4,575,400
Preferred and Preference Stock —without mandatory redemption requirements (a)(b):				
Original Preferred—5%, prior, cumulative, participating, not redeemable, par value \$8½ 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	—	—	—	50,000
9.20% Series	—	—	—	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:				
5.20% Convertible Series	115,957	25.00	2,899	3,745
\$100 Preference—par value \$100 per share	—	—	—	—
Total Preferred and Preference Stock—without mandatory redemption requirements			365,654	466,500
Preferred and Preference Stock —with mandatory redemption requirements (a)(c):				
\$100 Cumulative Preferred—par value \$100 per share (i):				
7.325% Series	630,000	\$104.04	63,000	66,000
7.80% Series	524,995	110.00	52,500	55,499
8.54% Series	660,000	105.65	66,000	68,250
8.70% Series A	485,624	110.00	48,562	51,188
12.00% Series	—	—	—	75,000
12.31% Series	500,000	105.83	50,000	50,000
Preference—par value \$25 per share: 7.375% Series	1,488,000	25.00	37,200	49,600
Preferred and Preference Stock to be redeemed within one year			317,262	415,537
Total Preferred and Preference Stock—with mandatory redemption requirements			(18,213)	(20,463)
Total Preferred and Preference Stock—with mandatory redemption requirements			299,049	395,074
Long-term Debt —				
First and Refunding Mortgage Bonds (d)(e)(f)(i):		Interest Rates		
Due 1987 through 1990		4¼%–10%	395,000	475,000
Due 1991 through 1995		5¼%–8½%	610,000	810,000
Due 1996 through 2000		7%–8¾%	890,030	490,030
Due 2001 through 2005		8¼%–9.95%	647,250	857,750
Due 2006 through 2021		7½%–16% and Variable	1,456,912	1,092,037
First Mortgage Bonds (Calectric)(d)(e)				
Due 1987 through 1991		4½%–5½%	38,000	46,000
Debentures				
Due 1992 through 1993		10½%–11%	200,000	200,000
Promissory Notes (b)(e)(g)(i)				
Due 1989 through 1997		11%–13%	156,109	233,958
Pollution Control Indebtedness (f)(i)				
Due 2008 through 2009		Variable	379,400	575,400
Other Long-term Debt (e)(h)		10.57%	26,797	28,657
Principal amounts outstanding			4,799,498	4,808,832
Long-term debt due within one year (e)			(103,315)	(45,110)
Unamortized debt premium or (discount)—net			(17,069)	(11,364)
Securities held by trustees (f)			(11,223)	(34,947)
Total Long-term Debt			4,667,891	4,717,411
Total Capitalization			\$10,126,869	\$10,154,385

Notes to Statements of Capitalization are on page 43.

Statements of Common Shareholders' Equity

	1986	1985	1984
	<i>(In Thousands)</i>		
Common Stock —par value \$4½ per share, 280,000,000 shares authorized, 216,906,527, 216,676,897 and 212,552,728 outstanding at December 31 of respective years (a)(b):	<u>\$ 903,777</u>	<u>\$ 902,821</u>	<u>\$ 885,637</u>
Additional Paid-In Capital:			
Balance at January 1	\$1,543,933	\$1,470,347	\$1,307,413
Premium received on sale of Common Stock and conversions (a)(b):	2,664	73,652	163,774
Capital stock expense	(56)	(66)	(840)
Additional Paid-in Capital at December 31	<u>\$1,546,541</u>	<u>\$1,543,933</u>	<u>\$1,470,347</u>
Earnings Reinvested in the Business:			
Balance at January 1	\$2,128,646	\$1,886,804	\$1,646,425
Add:			
Net income	768,617	774,107	732,428
	<u>2,897,263</u>	<u>2,660,911</u>	<u>2,378,853</u>
Less:			
Dividends declared on capital stock—			
Common—\$2.25 per share for 1986, \$2.13 per share for 1985 and \$2.01 per share for 1984	487,778	458,551	417,115
Original Preferred	2,131	2,016	1,891
Cumulative Preferred	51,311	67,676	68,203
Preference	3,062	4,022	4,840
	<u>544,282</u>	<u>532,265</u>	<u>492,049</u>
Loss on reacquired Preferred Stock	9,024	—	—
Earnings Reinvested at December 31 (c)	<u>\$2,343,957</u>	<u>\$2,128,646</u>	<u>\$1,886,804</u>
Total Common Shareholders' Equity at December 31	<u>\$4,794,275</u>	<u>\$4,575,400</u>	<u>\$4,242,788</u>

Notes to Statements of Common Shareholders' Equity are on page 43.

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

Notes to Statements of Capitalization—

(a) As of December 31, 1986, 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, 1986, 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, 1986 are as follows:

Year Ended December 31,	Maturities	Sinking Fund Requirements	Total
(In Thousands)			
1987	\$ 98,065	\$ 5,250	\$103,315
1988	74,292	5,250	79,542
1989	62,544	5,250	67,794
1990	349,823	5,725	355,548
1991	166,134	6,230	172,364

(c) For Preferred and Preference Stock with Mandatory Redemption Requirements, the aggregate mandatory redemption requirements for the five years subsequent to December 31, 1986 are as follows:

	No. of Shares	Commencing	Year Ended December 31,				
			1987	1988	1989	1990	1991
			(In Thousands)				
<u>\$100 Cumulative Preferred</u>							
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	1,800	1,800	1,800	1,800
8.54%	22,500**	6/30/86	—	—	2,250	2,250	2,250
8.70%A	13,125	6/30/85	1,313	1,313	1,313	1,313	1,313
12.31%	35,000***	4/30/88	—	3,500	3,500	3,375	3,375
<u>Preference</u>							
7.375%	496,000	2/01/85	12,400	12,400	12,400	—	—
			<u>\$18,213</u>	<u>\$22,013</u>	<u>\$24,263</u>	<u>\$11,738</u>	<u>\$11,738</u>

*Increases to 18,000 shares beginning in 1988.

**45,000 shares relating to 1987 and 1988 have been acquired through open market purchases.

***Decreases to 33,750 shares beginning in April 1990.

During 1986, the Company made optional redemptions of 22,500, 15,000 and 13,125 shares of the \$100 Cumulative Preferred Stock, 8.54% Series, 7.80% Series and 8.70%A Series, respectively. Such optional redemptions reduce the final series of mandatory redemption requirements.

(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 re-marketing 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 \$150,000,000 and \$6,109,000 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.

(i) The \$25 Cumulative Preferred Stock, 8.85% and 9.20% Series and the \$100 Cumulative Preferred, 12.00% Series were redeemed during 1986. The Company also reacquired \$1,391,000,000 of high interest rate long-term debt through tender offers and open market purchases.

Notes to Statements of Common Shareholders' Equity—

(a) At December 31, 1986, shares of Common Stock reserved for issuance were as follows:

	Shares
Conversion of Preference Stock, 5.20% Convertible Series	184,064
Conversion of 12½% Convertible Subordinated Debentures, Due 1997, Issued by Southern California Edison Finance Company N.V.	488,588
Stock purchase plans	4,238,575*
Total	4,911,227

*These plans include the Dividend Reinvestment and Stock Purchase Plan (DRP), Stock Savings Plus Plan (SSPP) and Employee Stock Ownership Plan (ESOP). Common Stock currently required for the plans are provided through open market purchases.

(b) Transactions in the capital stock accounts during 1986, 1985 and 1984 reflect the issuance of common stock through stock purchase plans, the conversion of 33,825, 30,323, and 70,687 shares in the respective years of Preference Stock, 5.20% Convertible Series (5.20% Series) and conversion of 12½% Convertible Subordinated Debentures, Due 1997, as follows:

Shares Issued	1986	1985	1984
DRP	—	2,942,754	5,389,210
SSPP	—	—	2,954,346
ESOP	—	—	1,214,803
5.20% Series	53,656	48,090	112,015
12½% Convertible Debentures	175,974	1,133,325	1,402,044

(c) Includes undistributed earnings of unconsolidated subsidiaries of \$25,328,000 and appropriated reinvested earnings related to certain federally-licensed hydroelectric projects of \$4,274,000 at December 31, 1986.

Notes to Financial Statements

NOTE 1—Summary of Significant Accounting Policies**Regulation—**

The Company is regulated by the California Public Utilities Commission (CPUC) and the Federal Energy Regulatory Commission (FERC). Accounting records are maintained in accordance with the Uniform System of Accounts prescribed by the FERC and adopted by the CPUC. The financial statements reflect the ratemaking policies of these commissions in conformity with generally accepted accounting principles applicable to rate-regulated enterprises.

Utility Plant—

The cost of additions, including replacements of units of property and betterments, is capitalized and included in utility plant. Costs include contracted work, direct material and labor, construction overhead, and an allowance for funds used during construction.

Maintenance, repairs, and minor replacements of and additions to property, are charged to maintenance expense. The cost of property replaced, renewed, or otherwise retired, plus removal or disposal costs, less salvage, is charged to accumulated depreciation.

Property-related accumulated deferred income taxes are deducted from utility plant in conformity with the ratemaking method used to determine rate base.

Allowance for Funds Used During Construction (AFUDC)—

AFUDC represents the cost of debt and equity funds, net of applicable income taxes, that finance the construction of new facilities. The amount of AFUDC capitalized is also reported in the Statements of Income as a reduction of interest charges for the borrowed funds component and as other income for the equity funds component. Although AFUDC increases net income, it does not represent cash earnings.

The cash recovery of AFUDC, as well as other costs of construction, occurs when completed projects are placed into commercial operation and related depreciation is authorized to be recovered through rates.

The AFUDC rate, which is compounded semiannually, was 10.53 percent for 1986, 10.40 percent for 1985, and 10.24 percent for 1984. These rates were calculated in accordance with a prescribed FERC formula.

Depreciation —

For financial reporting purposes, depreciation of utility plant, other than nuclear fuel, is computed on a straight-line, remaining life basis using the composite service lives by classes of depreciable property.

Estimated nuclear generating station decommissioning costs, aggregating \$328,085,000 as of December 31, 1986, are being recovered in rates through an annual allowance and charged to depreciation expense.

Nuclear Fuel—

The cost of owned and leased nuclear fuel, including its disposal, is amortized on the units of production method on the basis of generation over its service life. Nuclear fuel costs are recovered through regulatory balancing account mechanisms.

Special Funds—

Restrictions were placed on a portion of the proceeds from certain pollution control indebtedness pursuant to conditions in the related tax-exempt loan agreement. In compliance with loan conditions, such proceeds were utilized for the redemption of indebtedness incurred during the period in which the pollution control facilities were constructed.

Research and Development (R&D)—

R&D costs are expensed as incurred if they are of a general nature. R&D costs relating to specific projects in advance of construction are capitalized until a determination is made as to whether such projects will result in the construction of electric plant. If the construction of electric plant does not ultimately result, the costs are charged to expense.

	Year Ended December 31, 1986	1985	1984
	<i>(In Thousands)</i>		
R&D costs charged to expense	\$47,122	\$44,139	\$35,843
R&D costs deferred/capitalized	<u>3,888</u>	<u>1,030</u>	<u>3,946</u>
Total R&D expenditures	<u>\$51,010</u>	<u>\$45,169</u>	<u>\$39,789</u>

Income Taxes—

Deferred income taxes are provided for certain benefits realized from depreciation deductions utilized for tax purposes, regulatory balancing accounts, debt reacquisition expenses, and certain other specific items. Income tax accounting policies are discussed further 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. Debt reacquisition expenses 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.

Revenues—

Revenues are recorded based on cycle billings rendered to customers each month.

Regulatory Balancing Accounts—

Operating Revenues—

The CPUC has authorized an Electric Revenue Adjustment Mechanism that removes the effect on earnings of fluctuations in kilowatt-hour sales to retail customers. Under this mechanism, differences between authorized and recorded base rate revenues are accrued in a regulatory balancing account.

Energy Costs—

An Energy Cost Adjustment Clause (ECAC) balancing account adjusts results of operations for variations between the recorded fuel and purchased power costs and revenues collected to recover such costs. Differences are accumulated in the balancing account until they are recovered from or refunded to customers through future rate adjustments. In 1986, the ECAC balancing account included a fuel oil carrying charge based on short-term interest rates. In prior periods, such carrying charges were based on the earned rate of return on rate base.

Commencing in 1987, the CPUC has authorized a one-time write-down of the cost of fuel oil inventory to market prices and the subsequent use of the last-in, first-out method for measuring the recoverable cost of fuel oil consumption.

The one-time write-down, aggregating \$96.5 million, will be recorded in the ECAC balancing account pending future rate recovery.

The CPUC has established performance incentive mechanisms for San Onofre Nuclear Units 2 and 3 and the Palo Verde Nuclear Generating Station which set forth a targeted range of generation levels. Fuel savings or costs attributable to generation levels above or below the target range are divided equally between shareholders and customers.

Major Plant Additions—

Major Additions Adjustment Clause (MAAC) balancing account mechanisms have been established to account for the difference between revenues specifically authorized to provide recovery of San Onofre Units 2 and 3 and Palo Verde Units 1 and 2 ownership costs and those actually incurred.

Interest and Taxes—

Interest on regulatory balancing accounts is accrued at the most recent three-month prime commercial paper rate as published by the Federal Reserve. The weighted-average interest rates for the years 1986 and 1985 were 6.65% and 8.12% respectively. The income tax effects of the changes in the regulatory balancing accounts are deferred. Billed revenues and incurred costs are utilized in the determination of taxable income.

Subsidiaries—

Investments in unconsolidated subsidiary companies are accounted for by the equity method except subsidiaries engaged in Eurodebenture financings. For these subsidiaries, cash investments and short-term borrowings are presented separately on the Balance Sheet. Other subsidiaries are not considered significant for financial reporting purposes.

Reclassifications—

Certain items have been reclassified in prior periods to conform them to the classifications at December 31, 1986.

NOTE 2—Regulatory Matters**Nuclear Generating Facilities****Palo Verde Units 1, 2 and 3—****Stipulated Rate Treatment and Disallowance—**

Palo Verde Units 1 and 2 have been in commercial operation for ratemaking purposes since February 1, and September 19, 1986, respectively. Unit 3 is scheduled for commercial operation in late 1987. On May 31, 1985, an application was filed with the CPUC for rate recovery of Unit 1 operating and ownership costs. This filing requested rate recovery on the basis of traditional ratemaking practices commencing when the unit achieved commercial operation.

On June 17, 1985, in response to a CPUC order to investigate ratemaking alternatives for the investment in Palo Verde, the CPUC Public Staff recommended an unconventional ratemaking method for the output of the Palo Verde units. This ratemaking method, which is known as "avoided cost," was designed for non-utility power plants. Under this method, generation is 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 the CPUC Public Staff to investigate other ratemaking methods which satisfy the CPUC's objectives of ensuring cost effectiveness and fairly allocating the plant's costs between current and future ratepayers.

In response to the Commission's directive and to avoid the protracted hearings and substantial expense that a formal reasonableness review might have entailed, the Company and the Public Staff negotiated an agreement on Palo Verde ratemaking issues and, on June 25, 1986, filed a joint stipulation with the CPUC. The stipulation, approved by the CPUC on October 1, 1986, provides for:

- A disallowance of the Company's Palo Verde investment for ratemaking purposes based on 19.33% of the amount disallowed in the San Onofre Units 2 and 3 reasonableness review.

- A 10-year rate phase-in plan, which provides for the deferral during the first four years of operations of \$200 million of investment related revenue for each of the three units commencing on their commercial operation date. Revenue deferred for each unit under the plan for years 1 through 4 is \$80 million, \$60 million, \$40 million and \$20 million, respectively. Such deferrals are to be recovered, with interest, during the final six years of the phase-in plan.
- A target capacity factor operating performance incentive mechanism substantially identical to the procedure in effect for San Onofre Units 2 and 3.

Because Palo Verde Units 1 and 2 were placed in commercial operation before the investigation of alternative ratemaking methods could be completed, the CPUC authorized the implementation of an interim balancing account procedure for the costs of owning and operating Units 1 and 2. With CPUC approval of the stipulation, a reclassification from the interim balancing account to a deferred asset account was made during 1986 to record the phase-in plan deferrals for Units 1 and 2. The deferred asset balance aggregates \$90.6 million, including interest, as of December 31, 1986.

The Financial Accounting Standards Board is considering the appropriate accounting treatment for rate phase-in plans. The FASB expects to issue revised accounting standards for such plans during 1987.

As more fully discussed below, the CPUC issued its decision on the reasonableness of \$3.4 billion of the Company's investment in San Onofre Units 2 and 3 ordering that \$258.6 million of costs be disallowed for ratemaking purposes. Based on this decision, \$50 million of the estimated \$1.5 billion investment in Palo Verde would also be disallowed.

San Onofre Units 2 and 3—**Rate Treatment—**

When San Onofre Units 2 and 3 were placed in commercial operation in 1983 and 1984, respectively, the CPUC did not authorize recovery of the full cost of these units through customer rates. Instead, the CPUC authorized the recovery of a portion of costs and directed the accrual, in a MAAC balancing account, of the portion of revenues not included in rates. These accrued revenues have been included in reported earnings without benefiting cash flow.

Since January 1, 1985, the total authorized customer rates for San Onofre Units 2 and 3 have approximated investment-related costs.

CPUC Disallowance—

The CPUC has concluded its review of \$3.4 billion of the Company's investment in San Onofre Units 2 and 3 to determine the reasonableness of construction costs for rate recovery purposes.

On October 24, 1986, the Administrative Law Judge (ALJ) who presided over the reasonableness review proceedings issued his recommended decision in this case. The ALJ's decision recommended that none of the San Onofre Units 2 and 3 investment costs be disallowed for rate-making purposes.

On October 29, 1986, the CPUC issued its decision in this proceeding. Based on the Company's 75.05% ownership interest, the CPUC disallowance for ratemaking purposes would be \$258.6 million of the \$3.4 billion investment in San Onofre Units 2 and 3 under review. Under the Palo Verde stipulation discussed above, \$50 million of the Company's estimated \$1.5 billion Palo Verde investment would also be disallowed for ratemaking purposes. The Company's share of the disallowances for San Onofre Units 2 and 3 and Palo Verde is \$308.6 million.

On December 8, 1986, the Company filed an application for rehearing of \$213.4 million of the \$258.6 million disallowance with the CPUC. The uncontested \$45.2 million of San Onofre disallowance has been increased by 19.33% in compliance with the stipulated ratemaking agreement for Palo Verde investment costs, bringing the total uncontested disallowance to \$54 million. In the fourth quarter of 1986, an after-tax write-off of \$15 million, or 7¢ per share, was recorded to reverse earnings previously flowed through the income statement related to the uncontested \$54 million disallowance.

The ultimate amount of disallowance may be affected by the timing and outcome of our appeal to the CPUC for rehearing or by a possible appeal to the California Supreme Court. If our appeals are decided in 1987, as anticipated, and are denied in their entirety, the Company currently estimates that an additional after-tax write-off in the amount of \$314 million will be recorded, of which \$102 million, or 47 cents per share, will be recorded in 1987 to reverse earnings previously reflected in the income statement related to

the remaining disallowance of San Onofre and Palo Verde construction costs and \$212 million will be recorded as a one-time restatement as discussed below.

The Financial Accounting Standards Board recently adopted a new accounting standard requiring the write-off of construction costs disallowed and excluded from rate base. The new accounting standard, which becomes effective for the Company on January 1, 1988, provides for the restatement of prior period financial statements for cost disallowances occurring prior to the effective date of the new standard.

Accordingly, assuming that the Company's appeals are decided in 1987, as anticipated, in 1988 financial statement presentations including 1986 and 1987 financial statements, the disallowance will result in a one-time restatement of the 1986 financial statements. If the Company's appeals are denied in their entirety, in its 1988 financial statement presentations, the Company will record an after-tax charge against 1986 earnings in the amount of \$212 million (including the after-tax effect of the uncontested \$54 million disallowance), or 97 cents per share, to reflect the one-time rate base adjustment. The related restatement of shareholders' equity will be reflected in the 1988 presentation of 1986 and 1987 financial statements.

If the Company's appeals are decided after 1987, the new accounting standard requires that any resulting write-offs be treated as a charge against earnings in the year of the decision. Under these circumstances, only the after-tax effect of the uncontested \$54 million investment disallowance would be recorded as a one-time restatement in 1986.

The Company cannot determine the probable financial effect that the final outcome of this matter will have on its financial position and results of operations.

Fuel Supply Contract Settlements and Proposed Disallowance—

During 1985, an agreement was reached with a major fuel oil supplier to settle litigation arising from the termination of a fuel supply contract. In accordance with the agreement, \$350 million was paid to the supplier and a ten-year option agreement for the purchase of low sulfur fuel oil was entered into. Under the terms of the option agreement, \$9 million is paid annually for the supplier's commitment to deliver fuel oil on relatively short notice at current market prices.

Uranium supply contract termination agreements have been reached to cancel contractual purchase obligations with two uranium suppliers. As of December 31, 1986, the Company has paid an \$18.2 million settlement amount relating to one of the suppliers and \$55.8 million as a partial settlement of a \$63.9 million termination obligation relating to the other uranium supplier.

On July 29, 1986, the CPUC Public Staff recommended that \$95 million of the settlement with the major fuel oil supplier be disallowed. During 1986, hearings took place in which the Company presented its rebuttal to the Public Staff's recommendations. Approximately \$54 million of the proposed disallowance, alleged to be unreasonable by the Public Staff, represents the difference between the settlement payment and an amount referred to in a memorandum prepared for internal use by the Company. The proposed disallowance is also based on the Public Staff's allegations that the FERC rate settlement reached in 1986 with the Company's resale customers provided for, on a jurisdictionally comparable basis, a settlement amount less than the full \$350 million fuel oil settlement. The Public Staff also alleges that the settlement is in excess of an amount equivalent to that paid by another California utility during 1984 in connection with a similar litigation settlement. The remainder of the disallowance includes interest through June 1, 1987 and approximately \$29 million based on a 10% risk-sharing proposal. Opening briefs were filed in December 1986 and closing briefs were filed in January 1987. In its opening brief, the Public Staff proposed several new bases for disallowance including amounts ranging from \$35 million to as much as \$100 million. The Public Staff also proposed that the allowable portion of settlement cost be recovered without interest over four years. A decision is expected by mid-1987.

The Public Staff has also recommended that payments under the 10-year purchase option agreement with the fuel oil supplier be disallowed as unreasonable because they allege that the fuel oil supply contract is currently unnecessary and that the payments are not cost effective. As an alternative, the Public Staff proposes that the Company recover the option agreement payments to the extent that they are offset by savings from reduced fuel oil inventory levels.

The reasonableness of the uranium contract settlements is being addressed as part of a Commission investigation on uranium procurement practices for which hearings commenced in August 1986.

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 unable to determine whether the CPUC will allow recovery of 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 that will have a material adverse effect on its financial condition. The portion of such settlement costs attributable to wholesale customers was included in resale rates effective March 7, 1986.

Settlement payments for fuel oil and uranium contracts have been recorded in a regulatory balancing account pending a decision by the CPUC regarding rate recovery.

Tax Reform—

As explained more fully in Note 4, the CPUC is investigating the regulatory impact of the Tax Reform Act of 1986. Commencing January 1, 1987, revenue designed to recover federal income tax expense is being collected subject to refund pending the outcome of the investigation.

Resale Rates—

In accordance with FERC procedures, 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, 1986, revenues subject to refund aggregated approximately \$782 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 results of operations.

NOTE 3—Short-term Borrowings

Unrestricted deposits aggregating approximately \$7 million are maintained at commercial banks in order to continue various lines of credit for general corporate purposes. In addition, commencing in 1986, fuel oil inventory is being financed by commercial paper borrowings supported by new and separate lines of credit. Commercial paper issued by a wholly-owned subsidiary is being used for the capitalization of an affiliate engaged in Eurodebenture borrowings. The subsidiary's commercial paper has been guaranteed by the Company and is presented on its Balance Sheet.

Amounts and weighted average interest rates for the lines of credit are as follows:

1986	General Purpose	Fuel Oil	Subsidiary	Total
<i>(In Millions)</i>				
Lines of Credit	\$501.0	\$300.0	\$ 50.0	\$851.0
Amount Outstanding	115.0	213.0	48.8	376.8
Weighted Average Interest Rate	7.0%	6.4%	6.4%	6.8%
1985				
Lines of Credit	\$572.0	—	\$ 96.4*	\$668.4
Amount Outstanding	15.0	—	148.9	163.9
Weighted Average Interest Rate	8.9%	—	8.2%	8.2%

*Borrowings in excess of subsidiary lines of credit are supported by general purpose lines of credit.

NOTE 4—Income Taxes

Current and Deferred Taxes—

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

Year Ended December 31,	1986	1985	1984
<i>(In Thousands)</i>			
Current:			
Federal	\$324,733	\$ (39,600)	\$140,510
State	108,290	24,841	56,760
	<u>433,023</u>	<u>(14,759)</u>	<u>197,270</u>
Deferred—Federal and State:			
Investment tax credits—net	59,252	84,134	55,323
Accelerated cost recovery system property	170,848	145,957	129,808
Debt reacquisition expenses	81,968	24,453	31,180
Regulatory balancing accounts	(39,744)	365,296	205,013
Fuel contract settlements	9,528	91,681	(15,104)
Other	(14,125)	12,248	6,719
	<u>267,727</u>	<u>723,769</u>	<u>412,939</u>
Total income tax expense	<u>\$700,750</u>	<u>\$709,010</u>	<u>\$610,209</u>
Income taxes included in operating expenses	\$711,493	\$720,938	\$639,875
Income taxes included in other income	(10,743)	(11,928)	(29,666)
Total income tax expense	<u>\$700,750</u>	<u>\$709,010</u>	<u>\$610,209</u>

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

For ratemaking purposes, property-related accumulated deferred federal income taxes are deducted from rate base and amortized or otherwise applied as a reduction (or increase) in federal income tax expense in future years. Accumulated deferred investment tax credits (ITC) are amortized over the lives of the related properties. Tax deductions relating to construction overheads such as interest, pension provisions and taxes charged to construction are accounted for as current reductions in income tax provisions. Deferred income taxes for such deductions and tax depreciation prior to 1981 have not been provided because the tax effects of such timing difference reversals are not allowed for retail rate-making until the taxes become payable. The cumulative net amounts of these timing differences were \$1,803 million at December 31, 1986 and \$2,014 million at December 31, 1985.

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 percent and 51.184 percent, respectively.

Year Ended December 31,	1986	1985	1984
<i>(In Thousands)</i>			
Expected federal income tax expense at statutory rate	\$ 675,908	\$ 682,234	\$ 617,613
Increase (Decrease) in income tax expense resulting from:			
Allowance for equity and borrowed funds used during construction	(62,202)	(72,539)	(89,602)
Federal deduction for state taxes on income	(55,355)	(54,578)	(46,414)
Depreciation timing differences not deferred	101,896	92,900	77,841
State tax provision	120,337	118,647	100,900
All other differences	(79,834)	(57,654)	(50,129)
Total income tax expense	<u>\$ 700,750</u>	<u>\$ 709,010</u>	<u>\$ 610,209</u>
Pretax income	<u>\$1,469,367</u>	<u>\$1,483,117</u>	<u>\$1,342,637</u>
Effective tax rate (Total income tax expense ÷ Pretax income)	<u>47.7%</u>	<u>47.8%</u>	<u>45.4%</u>

Tax Reform—

The Tax Reform Act of 1986 (Act) retroactively repealed ITC for property placed into service after December 31, 1985, except for property then under construction for which there are various transitional rules. However, the Act requires a 100% reduction in depreciable basis for any transitional ITC. Because the Company defers the recognition of ITC, its elimination has not significantly impacted earnings.

Commencing in 1987, the Act requires the capitalization of construction overhead and financing costs for determining the depreciable basis of certain properties for tax purposes. This change will increase taxable income and reduce the differences between construction costs for tax and financial accounting purposes.

The Act will also reduce federal income tax rates to 40 percent in 1987 and 34 percent in 1988 and later years. The provisions of the Act are not expected to adversely affect net income.

Under present accounting standards, deferred income tax balances are not adjusted to reflect changes in income tax law or rates. However, an amendment to present accounting requirements has been proposed which would require adjustment of deferred tax balances to reflect the effects of such changes commencing in 1988.

Ratemaking Investigation—

The CPUC has initiated an investigation to determine the effects of tax reform on ratemaking practices. The investigation will consider whether and to what extent reductions in certain non-property related deferred tax balances should be conveyed to customers through reduced rates. Any refunds ultimately required by the CPUC should not adversely affect earnings but would prevent the retention of the benefits of the tax rate reductions by the Company.

NOTE 5—Employee Benefit Plans**Pension Plan—**

A trustee, non-contributory pension plan is maintained which covers substantially all employees. The annual normal cost of the plan is funded by 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 on the basis of actuarial determinations and amounted to \$48,579,000, \$57,859,000 and \$54,820,000 for the years 1986, 1985, and 1984, respectively.

	At January 1, 1986 (a)	1985
	(In Thousands)	
Actuarial present value of accumulated plan benefits:		
Vested	\$653,216	\$608,240
Non-vested	51,761	49,460
	<u>\$704,977</u>	<u>\$657,700</u>
Net assets available for plan benefits	<u>\$972,063</u>	<u>\$795,845</u>

(a) Latest available data.

Actuarial rate of return assumptions used in determining the present value of accumulated plan benefits were 8% and 7.5% as of January 1, 1986 and 1985, respectively.

Effective in 1987, a new accounting standard will modify pension plan accounting practices. Under existing regulatory policies, earnings will not be affected but assets or liabilities will be recognized to the extent that cumulative pension contributions are above or below the levels determined under the actuarial method prescribed by the new standard.

Employee Stock Plans—

An Employee Stock Ownership Plan (ESOP) and a Stock Savings Plus Plan (SSPP) are maintained to supplement employees' retirement income. Contributions to the ESOP are funded primarily by Federal income tax benefits and contributions made by participating employees. Contributions to the SSPP amounted to \$15,445,000, \$13,878,000 and \$12,539,000 for the years 1986, 1985 and 1984, respectively.

Other Post-Retirement Benefits—

Certain health care and life insurance benefits are provided 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 facilities and insurance programs. The cost of providing these benefits to retirees was \$15,415,000, \$13,100,000 and \$8,900,000 for the years 1986, 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 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 investment in each such project as reported on the Balance Sheet as of December 31, 1986:

Projects	Utility Plant in Service	Accumulated Depreciation	Construction Work in Progress	Ownership Interest
(In Thousands)				
El Dorado Transmission System	\$ 21,373	\$ 7,424	\$ 54	60.0%(a)
Four Corners Coal Generating Station—Units 4 & 5	385,234	82,812	9,585	48.0
Mohave Coal Generating Station	209,534	79,127	2,270	56.0
Pacific Intertie DC Transmission System	109,563	29,719	2,800	50.0
Palo Verde Nuclear Generating Station	983,200	16,557	497,301	15.8
San Onofre Nuclear Generating Station:—				
Unit 1	499,132	115,480	24,066	80.0
Units 2 & 3	2,919,505	310,269	24,565	75.05
Common Facilities—				
Units 2 & 3	812,722	64,135	6,250	75.05
Common Facilities—				
Units 1, 2 & 3	165,154	17,282	9,768	75.87
Solar One Generating Station	18,068	15,855	—	80.0
Yuma Axis Combined Cycle Generating Station	12,369	9,485	—	33.3
Total	\$6,135,854	\$748,145	\$576,659	

(a) Represents a composite rate.

NOTE 7—Leases

Rental payments charged to operating expenses amounted to \$130,497,000, \$112,284,000 and \$127,022,000 for the years 1986, 1985 and 1984, 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 ECAC procedure.

The nuclear fuel lease meets the criteria requiring capitalization under generally accepted accounting principles for unregulated enterprises. Had this lease been capitalized, the Balance Sheets would have included additional assets and liabilities of approximately \$524 million and \$551 million at December 31, 1986 and 1985, respectively. In accordance with an accounting standard applicable to rate regulated enterprises, the assets and obligations of the nuclear fuel lease will be recorded on the Balance Sheet commencing in 1987.

At December 31, 1986, estimated rental commitments for non-cancelable operating leases consisted of the following:

Year Ended December 31,	(In Thousands)
1987	\$20,996
1988	18,788
1989	16,515
1990	14,131
1991	12,022
For Periods Thereafter	<u>15,553</u>
Total Future Rental Commitments	<u>\$98,005</u>

NOTE 8—Commitments

Construction Program and Fuel Supply—

Significant purchase commitments exist in connection with the continuing construction program. As of December 31, 1986, budgeted construction expenditures are estimated at \$1,033,228,000 for 1987, \$883,567,000 for 1988 and \$893,893,000 for 1989. Minimum long-term commitments

of approximately \$1,478,000,000, exclusive of the amounts required by the contract settlements with major fuel suppliers discussed in Note 2, existed on December 31, 1986 under 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, a quarterly fee of one mill per kilowatt-hour is paid 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 \$26,091,000 at December 31, 1986. The obligation for this one-time fee is being discharged by equal payments over 40 quarters. Such payments commenced during 1985. The amounts charged to income for current generation were \$10,740,000, \$8,925,000 and \$7,707,000 for the years ended December 31, 1986, 1985 and 1984, respectively. Expenses associated with disposal of spent nuclear fuel are recovered through the ECAC procedure.

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 there is no investment in such facilities, these contracts provide for the payment of 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 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 ECAC balancing account procedure. Selected information as of December 31, 1986 pertaining to purchased power contracts is summarized in the following table:

Share of Effective Operating Capacity—	
Megawatts(a) (b)	350
Share of Energy Output (a) (b)	100%
Total Estimated Annual Cost (a)	\$110,141,000
Company's Portion of Estimated Annual Cost	
Applicable to Suppliers' Annual Minimum Debt	
Service Requirement (a)	\$ 18,369,000
Company's Allocable Portion of Interest of Suppliers	
Included in Annual Minimum Debt Service	\$ 17,693,000
Related Long-Term Debt or Lease Obligations	
Outstanding	None

- (a) Amounts have been reduced from those reported previously due to the exclusion of a contract which is no longer long-term.
 (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, 1986 pertaining to both purchased power and transmission service contracts is summarized in the following table:

	Purchased Power (a)	Transmission Service
Dates of Expiration	1987-1990	1990-2016
Variable Components of Contracts	(b)	(b)
Required Future Minimum Annual Payments	<i>(In Thousands)</i>	
1987	\$ 57,378	\$ 11,524
1988	56,310	11,588
1989	41,547	9,812
1990	13,017	6,473
1991	—	4,474
Later years	—	94,926
Total	168,252	138,797
Less Amount Representing Interest to		
Reduce Total to Present Value	<u>(32,491)</u>	<u>(72,178)</u>
Total at Present Value	<u>\$135,761</u>	<u>\$ 66,619</u>
Total Purchases for the Years Ended		
December 31,		
1986	\$115,322	\$ 12,007
1985	91,421	10,090
1984	32,023	7,970

- (a) Amounts have been reduced from those reported previously due to the exclusion of a contract which is no longer long-term.
 (b) The variable components of certain contracts are based on 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 \$690 million 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, in the maximum available amount, presently \$160 million with the balance to be provided by secondary financial protection required by the Nuclear Regulatory Commission (NRC). Under the agreement with the NRC, retrospective premium adjustments of up to \$26,170,000 per year could be assessed in the event of nuclear incidents involving any licensed reactor in the United States. The Price-Anderson Act is scheduled to expire in 1987; however, Congress is considering proposals to amend and extend the act.

Property damage coverage is provided for losses up to \$500 million at the San Onofre and Palo Verde Nuclear Generating Stations. Decontamination liability and property damage insurance in excess of the primary \$500 million 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 \$3,100,000 for a single unit for 52 weeks commences after the first 26 weeks of such an outage. An additional \$1,550,000 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 \$59,803,000 per year. Insurance premiums 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 943 megawatts. These licenses also cover certain storage and regulating reservoirs and related transmission facilities.

The above licenses expire at various times between 1987 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 for the relicensing of certain hydroelectric plants referred to above with aggregate effective operating capacity of 61 megawatts are pending. Any new licenses received 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 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 anticompetitive behavior by charging more for electricity sold to the resale customers than is charged to 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' purchases from the Company ("foreclosure"). The plaintiffs 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 \$76,800,000 before trebling, for the period February 1, 1978 to December 31, 1985. The trial began on July 8, 1986, and concluded on September 26, 1986. Findings of Fact and Conclusions of Law were filed by the Company with the Court on November 21, 1986. No date has been given for the decision. The foregoing proceedings involve complex issues of law and fact and, although the Company is unable to predict their final outcome, it has categorically denied the allegations of these resale customers.

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

RESULTS OF OPERATIONS

Earnings Summary

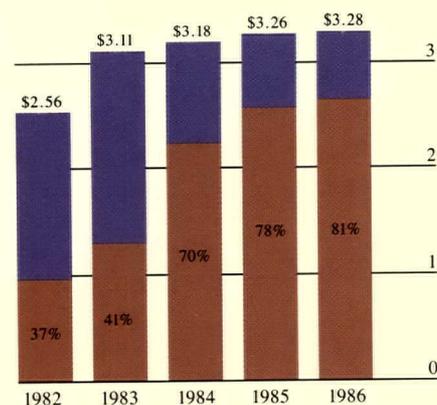
Record earnings per share of \$3.28 were achieved for 1986, up moderately from \$3.26 in 1985. Net income declined slightly for 1986 reflecting the CPUC's reduction of the Company's authorized rate of return from 16 percent to 14.6 percent, a charge to earnings related to the uncontested portion of the CPUC's nuclear plant investment cost disallowances and refunds to wholesale customers resulting from Federal Energy Regulatory Commission (FERC) decisions. The effects of these regulatory adjustments were partially offset by a favorable coal plant incentive reward. Reductions in interest and preferred dividends resulting from the Company's aggressive refinancing program contributed to the higher level of Earnings Available for Common and Original Preferred Stock.

As shown in the chart below, earnings exclusive of non-cash Allowance for Funds Used During Construction (AFUDC) as a percentage of total earnings increased to 81 percent in 1986, the highest level since 1974. Continued improvement in earnings quality is expected in 1987 and 1988 as major nuclear and hydroelectric projects are placed into commercial operation and included in rate base.

Quality of Earnings

■ Allowance for Funds Used During Construction

Per Share \$4



Operating Revenues and Sales

Approximately 96 percent of the Company's operating revenues are subject to the jurisdiction of the CPUC. The remaining 4 percent represents sales to wholesale customers which are regulated by the FERC.

Operating revenues increased over the prior year by \$143 million or 2.8 percent despite a 1.2 percent decline in kilowatt-hour sales resulting from mild temperatures and reduced sales to resale and industrial customers who obtained more of their power from outside the Edison system or from self-generation. Increases in operating revenues totaling \$270 million or 5.5 percent in 1985 and \$435 million or 9.7 percent in 1984 reflect, in addition to the effect of rate changes, increases in kilowatt-hour sales of 2.6 percent and 5.7 percent, respectively.

The net effect of changes in rates was to increase the overall revenue per kilowatt-hour by 3.9 percent in 1986, 3.4 percent in 1985, and 3.8 percent in 1984.

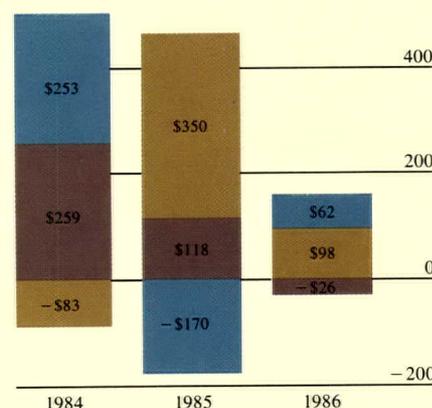
The chart below shows the changes in the major components of operating revenues which contributed to the overall increase for the past three years.

Effective January 1, 1987, the CPUC authorized an attrition allowance increasing annual revenues by \$2.9 million. The attrition allowance recognizes increases in rate base and

Operating Revenues—Changes

■ Base Rate Changes
 ■ Sales Volume Changes
 ■ Balancing Account Rate Changes

Millions \$600



operating costs and reduced capital costs. The decline in capital costs resulted from the CPUC's downward adjustment in the Company's authorized return on common equity from 14.6 percent in 1986 to 13.9 percent in 1987 and lower interest rates from refinancing activities.

Revenues collected in 1987 for the recovery of federal income tax expense are subject to refund pending the outcome of a CPUC investigation of the effects of the Tax Reform Act of 1986 on customer rates.

Operating Expenses

Fuel expenses declined over \$800 million compared to the prior year reflecting reduced natural gas prices and increased use of lower cost nuclear and coal generation. In addition, 1985 fuel expenses were greater due to fuel contract settlement payments.

The effect on earnings of fluctuations in the Company's fuel and purchased power expenses have been minimized by regulatory adjustment clauses established by the CPUC and the FERC.

Increases in maintenance, other operating, and depreciation expenses continue to be influenced by system growth, including the commercial operation of Palo Verde Nuclear Generating Station Unit 1 on February 1, 1986 and Unit 2 on September 19, 1986. These trends are expected to continue as the costs of operating and maintaining Palo Verde Units 1 and 2 are reflected in future periods and when Unit 3 is placed into commercial operation, which is scheduled for late 1987.

Recovery of depreciation expense attributable to San Onofre Units 2 and 3 and Palo Verde Units 1 and 2 is authorized through the Major Additions Adjustment Clause and the Palo Verde Phase-In Plan. Increases in depreciation expense related to these units which are not recovered through current rates are recorded in balancing and deferred asset accounts pending future rate recovery and, therefore, do not affect earnings.

The reduction in income tax expense is attributable to decreases in pre-tax income and deferred income tax provisions.

As explained more fully in Note 4 of "Notes to Financial Statements," the decline in the corporate tax rate under the Tax Reform Act of 1986 (Act) will reduce income tax expense in 1987 and future years. The reduction in federal in-

come tax expense will be accompanied by a reduction in customer rates and thus is expected to have little or no impact on net income.

Any refunds which may result from the CPUC's investigation to determine the effects of tax reform on ratemaking practices are not expected to significantly affect net income but would prevent the Company from retaining the benefits of reduced deferred tax balances resulting from declines in corporate income tax rates.

Other Income

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 from prior year levels resulted from a 34 percent or \$700 million decline in Construction Work In Progress. The decline is due primarily to the transfer of Palo Verde Units 1 and 2 to Utility Plant during 1986.

Interest income increased by \$12.7 million over 1985 reflecting interest accrued on increased balancing account undercollections and revenue deferred pursuant to the Palo Verde Phase-in Plan.

Pending Cost Disallowance Appeal

The Company has submitted a petition for rehearing on \$213.4 million of its \$258.6 million share of San Onofre nuclear plant investment costs disallowed by the CPUC. The impact this matter may have on earnings depends on the timing and outcome of our appeal to the CPUC for rehearing and a possible appeal to the California Supreme Court. For a further discussion of the financial implications of this matter, refer to Note 2 of "Notes to Financial Statements."

FINANCIAL CONDITION**Internal Generation of Funds**

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

Almost 80 percent of the Company's capital requirements in 1986 were provided by internally generated funds, the highest level in over 25 years. The increased level of funds generated internally is primarily attributable to placing completed nuclear facilities into rate base and tax benefits resulting from growth in the Company's investment in plant assets.

The Tax Reform Act of 1986 will have a negative effect on the Company's internal generation of funds. The negative impact results from the retroactive repeal of the investment tax credit and reduced allowable deductions for depreciation. Any refund of prior years' deferred tax balances ultimately required by the CPUC to reflect corporate tax rate reductions resulting from the Act would have a further negative impact on internally generated funds.

The Company's cash flow and liquidity will also be adversely affected by revenues deferred to future ratemaking periods pursuant to the Palo Verde Phase-In Plan. The timing and amount of revenue deferred under this plan is discussed in Note 2 of "Notes to Financial Statements."

Liquidity and Capital Resources

The Company's liquidity is affected principally by its construction program, financing associated with regulatory balancing accounts and by other capital requirements including debt and capital stock maturities. The capital resources available to meet those requirements include funds from internal generation and external financing. Internally generated funds depend upon economic conditions and the adequacy of timely rate relief. External financing through short-term borrowings and security issuances is influenced by market conditions and other factors including limitations imposed by the Company's Articles of Incorporation and Trust Indenture. At December 31, 1986, the Company could issue approximately \$4.4 billion of additional First and Refunding Mortgage Bonds or \$4.3 billion of preferred stock at current interest and dividend rates.

Capital Requirements

The following table presents the Company's projected capital requirements for 1987 through 1991:

	1987	1988	1989	1990	1991
	<i>(In millions)</i>				
Construction Expenditures	\$1,033	\$ 884	\$ 894	\$ 889	\$ 810
Maturities of					
Long-Term Debt	103	80	68	356	172
Redemptions of Preferred and Preference Stock . . .	18	22	24	12	12
Capital Requirements	<u>\$1,154</u>	<u>\$ 986</u>	<u>\$ 986</u>	<u>\$1,257</u>	<u>\$ 994</u>

Projected construction expenditures include major transmission and hydroelectric projects.

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, 1986 is reflected in the table below:

Common Equity	47.3%
Preferred and Preference Stock	6.6
Long-Term Debt	46.1
Total	<u>100.0%</u>

The Company completed \$1.4 billion of long-term financings during 1986. The proceeds of these financings and additional short-term borrowings were used primarily to refinance higher cost securities.

Effective January 1, 1986, the CPUC amended its energy cost ratemaking policy to provide recovery of fuel oil inventory financing costs based upon short-term debt interest rates. Recovery of such costs was previously based on the Company's earned rate of return on rate base. In conformity with the revised procedures, the Company utilizes short-term borrowings to finance fuel oil inventory. The \$313 million increase in short-term borrowings in 1986 is attributable primarily to fuel oil inventory financing. Details of the Company's lines of credit and related short-term borrowings are discussed in Note 3 of "Notes to Financial Statements."

Operating Revenues and Kilowatt-Hour Sales

Class of Service	Operating Revenues				Kilowatt-Hour Sales (000)			
	% of 1986 total	(In Thousands)		% change	% of 1986 total	1986	1985	% change
		1986	1985					
Residential	28.4	\$1,510,925	\$1,449,424	4.2	29.2	18,766,947	18,582,806	1.0
Agricultural	1.4	73,260	84,282	(13.1)	1.3	851,862	1,014,564	(16.0)
Commercial	33.4	1,777,551	1,625,179	9.4	31.4	20,145,578	19,110,474	5.4
Industrial	23.0	1,219,822	1,207,470	1.0	24.3	15,587,730	15,707,038	(0.8)
Public Authorities	8.7	461,366	427,704	7.9	7.9	5,077,729	4,885,200	3.9
Interdepartmental	—	81	98	(17.3)	—	970	1,106	(12.3)
Resale	4.4	232,542	347,578	(33.1)	5.9	3,766,589	5,683,378	(33.7)
Sales of Electric								
Energy	99.3	5,275,547	5,141,735	2.6	100.0	64,197,405	64,984,566	(1.2)
Other Electric Revenues	0.7	36,186	27,113	33.5	—	—	—	—
Total	100.0	\$5,311,733	\$5,168,848	2.8	100.0	64,197,405	64,984,566	(1.2)

Operating Revenues by Rate Components

Rate Components	Operating Revenues			Percent of Total		
	1986	(In Thousands)		1986	1985	1984
	1986	1985	1984			
Base Rates—CPUC Jurisdiction	\$2,522,565	\$2,411,836	\$2,382,081	47.5	46.7	48.6
Energy Cost Adjustment Billing Factor	1,798,697	1,587,763	1,413,433	33.8	30.7	28.9
Annual Energy Rate	12,173	115,027	211,103	0.2	2.2	4.3
Major Additions Adjustment Billing Factor	801,276	732,232	395,545	15.1	14.2	8.1
Other Billing Factors	(91,765)	(52,617)	145,522	(1.7)	(1.0)	3.0
Resale Rates (excluding fringe)	232,601	347,494	295,275	4.4	6.7	6.0
Sales of Electric Energy	5,275,547	5,141,735	4,842,959	99.3	99.5	98.9
Other Electric Revenues	36,186	27,113	56,193	0.7	0.5	1.1
Total	\$5,311,733	\$5,168,848	\$4,899,152	100.0	100.0	100.0

Selected Financial Data 1976-1986

		1986	1985
Summary of Operations <i>(in thousands, except percent and per share data)</i>	Operating Revenues	\$ 5,311,733	\$ 5,168,848
	Operating Expenses	4,343,830	4,196,094
	Fuel and Purchased Power Costs (a)	1,653,854	2,389,087
	Income Taxes (a)	711,493	720,938
	Allowance for Equity and Borrowed Funds Used During		
	Construction	135,222	157,694
	Total Interest Charges	482,855	487,800
	Net Income	768,617	774,107
	Earnings Available for Common and Original		
	Preferred Stock	\$ 713,933	\$ 702,409
	Weighted-Average Shares of Common and Original		
	Preferred Stock Outstanding (000)	217,732	215,649
	Per Share Data:		
	Earnings Per Common Share	\$3.28	\$3.26
	Dividends Declared Per Common Share	\$2.25	\$2.13
	Dividend Payout Ratio (paid basis)	67.7%	64.4%
	Rate of Return on Common Equity	15.06%	15.75%
Ratio of Earnings to Fixed Charges	3.83	3.80	
Balance Sheet Data <i>(in thousands, except percent and per share data)</i>	Total Assets (b)	\$13,244,952	\$12,593,449
	Gross Utility Plant	15,114,542	13,990,360
	Accumulated Depreciation	3,586,080	3,152,141
	Percent of Gross Utility Plant	23.7%	22.5%
	Common Stock, at par value	\$ 903,777	\$ 902,821
	Additional Paid-In Capital	1,546,541	1,543,933
	Earnings Reinvested in the Business	2,343,957	2,128,646
	Common Shareholders' Equity	4,794,275	4,575,400
	Preferred and Preference Stock		
	— without mandatory redemption requirements	365,654	466,500
	— with mandatory redemption requirements (c)	299,049	395,074
	Long-Term Debt (c)	\$ 4,667,891	\$ 4,717,411
	Capital Structure (percent):		
	Common Shareholders' Equity	47.3%	45.1%
	Preferred and Preference Stock		
	— without mandatory redemption requirements	3.6	4.6
	— with mandatory redemption requirements (c)	3.0	3.9
Long-Term Debt (c)	46.1%	46.4%	
Book Value Per Common Share	\$22.02	\$21.04	
Operating and Sales Data	Area Peak Demand (MW)	14,599	14,587
	Area Generating Capacity at Peak (MW)	18,320	17,776
	Total Energy Requirement (KWH) (000)	73,208,690	73,755,963
	Percent Energy Requirement:		
	Thermal	55.6%	58.7%
	Renewable/Alternative (including hydro)	7.9	6.0
	Purchased Power and Other Sources (d)	36.5%	35.3%
	Kilowatt-Hour Sales (000)	64,197,405	64,984,566
	Average Annual KWH Sales Per Residential Customer	5,999	6,099
	Number of Customers	3,589,414	3,490,325
Number of Employees	17,553	17,182	

(a) Included in Operating Expenses.

(b) The years 1976 through 1981 have been restated to reflect the deduction of property-related accumulated deferred income taxes from Utility Plant.

1984	1983	1982	1981	1980	1979	1978	1977	1976
\$ 4,899,152	\$ 4,464,256	\$ 4,302,602	\$4,054,356	\$3,661,117	\$2,563,974	\$2,328,798	\$2,064,914	\$1,846,540
3,932,527	3,760,225	3,765,875	3,563,201	3,288,983	2,178,978	2,004,197	1,734,192	1,539,400
2,084,941	2,027,756	2,227,901	2,558,206	2,010,227	1,532,903	1,204,749	1,189,597	903,447
639,875	497,236	177,251	197,865	38,683	100,292	72,803	68,792	59,506
194,787	365,856	303,118	232,552	162,287	118,566	78,421	60,238	47,610
530,322	539,377	420,282	340,977	282,656	205,082	182,658	161,078	144,368
732,428	690,780	555,754	489,912	317,536	346,219	251,683	251,979	226,798
\$ 659,385	\$ 617,303	\$ 483,358	\$ 422,024	\$ 256,586	\$ 292,481	\$ 202,226	\$ 206,330	\$ 185,047
207,576	198,348	188,514	171,220	146,482	128,404	114,954	108,694	97,356
\$3.18	\$3.11	\$2.56	\$2.46	\$1.75	\$2.28	\$1.76	\$1.90	\$1.90
\$2.01	\$1.83	\$1.69	\$1.55	\$1.42	\$1.30	\$1.15	\$1.03	\$.84
61.9%	57.7%	64.5%	61.5%	79.4%	55.7%	63.6%	50.5%	44.2%
16.3%	17.0%	14.9%	14.9%	10.4%	13.6%	10.7%	12.0%	12.4%
3.38	2.91	2.44	2.72	2.09	2.90	2.53	2.78	2.83
\$11,358,730	\$11,035,060	\$10,157,564	\$8,699,721	\$7,706,933	\$6,949,917	\$6,030,045	\$5,698,068	\$4,993,330
12,835,031	11,886,610	10,764,078	9,517,670	8,406,309	7,577,670	6,810,891	6,191,733	5,658,433
2,763,651	2,426,368	2,185,667	2,015,212	1,840,233	1,676,148	1,519,174	1,383,009	1,258,327
21.5%	20.4%	20.3%	21.2%	21.9%	22.1%	22.3%	22.3%	22.2%
\$ 885,637	\$ 839,501	\$ 805,766	\$ 730,027	\$ 632,115	\$ 540,791	\$ 521,138	\$ 455,387	\$ 442,739
1,470,347	1,307,413	1,193,318	999,764	805,325	638,046	595,701	458,096	427,424
1,886,804	1,646,425	1,393,780	1,238,317	1,092,137	1,054,296	931,217	862,956	769,425
4,242,788	3,793,339	3,392,864	2,968,108	2,529,577	2,233,133	2,048,056	1,776,439	1,639,588
467,258	469,025	471,020	476,308	482,652	489,822	503,650	518,172	537,753
422,286	440,500	445,000	399,500	399,500	324,500	197,000	197,000	75,000
\$ 4,248,647	\$ 4,051,836	\$ 3,970,400	\$3,444,080	\$2,945,824	\$2,746,207	\$2,477,474	\$2,314,874	\$2,151,861
45.2%	43.3%	41.0%	40.7%	39.8%	38.5%	39.2%	37.0%	37.2%
5.0	5.4	5.7	6.5	7.6	8.5	9.6	10.8	12.2
4.5	5.0	5.4	5.5	6.3	5.6	3.8	4.1	1.7
45.3%	46.3%	47.9%	47.3%	46.3%	47.4%	47.4%	48.1%	48.9%
\$19.89	\$18.76	\$17.48	\$16.87	\$16.60	\$17.11	\$16.29	\$16.15	\$15.34
15,189	13,464	13,149	13,738	12,841	12,662	12,159	11,564	11,315
17,354	16,365	15,349	15,592	15,504	15,071	14,966	14,278	14,071
72,431,689	68,020,197	66,578,540	69,179,641	65,459,278	66,216,910	63,877,116	63,344,706	59,427,973
54.0%	48.5%	55.5%	67.6%	71.2%	82.0%	73.8%	87.4%	75.1%
7.6	10.4	9.7	5.8	9.2	7.7	9.3	2.5	4.4
38.4%	41.1%	34.8%	26.6%	19.6%	10.3%	16.9%	10.1%	20.5%
63,310,047	59,892,583	59,326,853	62,451,319	59,915,187	59,517,861	57,027,035	57,726,273	53,685,378
6,147	5,879	5,685	5,879	5,939	6,010	5,883	5,630	5,650
3,400,182	3,325,308	3,275,144	3,232,687	3,163,968	3,082,382	2,986,545	2,900,856	2,814,403
16,844	16,292	15,797	14,569	14,157	12,917	12,845	12,671	12,510

(c) Excludes current portion.

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

Board of Directors

Howard P. Allen	<i>Chairman of the Board and Chief Executive Officer</i>
Roy A. Anderson	<i>Chairman of the Executive Committee, Lockheed Corporation, Calabasas, California</i>
Norman Barker, Jr.	<i>Former Chairman of the Board, First Interstate Bank of California, Los Angeles, California</i>
H. Frederick Christie	<i>President</i>
Warren Christopher	<i>Senior Partner, Law Firm of O' Melveny & Myers, Los Angeles, California</i>
Camilla C. Frost	<i>Chairman of the Executive Committee, Los Angeles County Museum of Art, Los Angeles, California</i>
Walter B. Gerken	<i>Chairman of the Board, Pacific Mutual Life Insurance Company, Newport Beach, California</i>
William R. Gould	<i>Chairman of the Board Emeritus and Consultant (Retired Chairman of the Board and Chief Executive Officer, Southern California Edison Company), Long Beach, California</i>
Joan C. Hanley	<i>General Partner and Manager, Miramonte Vineyards, Rancho California, California</i>
Jack K. Horton	<i>Chairman of the Executive Committee and Consultant (Retired Chairman of the Board and Chief Executive Officer, Southern California Edison Company), Los Angeles, California</i>
Carl F. Huntsinger	<i>General Partner of DAE Limited Partnership, Ltd. (Agricultural Management), Ojai, California</i>
J. J. Pinola	<i>Chairman of the Board and Chief Executive Officer, First Interstate Bancorp, Los Angeles, California</i>
James M. Rosser	<i>President, California State University at Los Angeles, Los Angeles, California</i>
Henry T. Segerstrom	<i>Managing Partner, C. J. Segerstrom & Sons (Real Estate Development), Costa Mesa, California</i>
E. L. Shannon, Jr.	<i>Chairman of the Board and Chief Executive Officer, Santa Fe International Corporation (Oil Service, Engineering, Petroleum Exploration and Production), Alhambra, California</i>
⁽¹⁾ H. Russell Smith	<i>Chairman of the Executive Committee, Avery International (Manufacturer of Self-Adhesive Products), Pasadena, California</i>
Edward Zapanta, M.D.	<i>Physician and Neurosurgeon, Monterey Park, California</i>

⁽¹⁾Mr. Smith, having reached retirement age, is not a nominee for re-election to the Board of Directors in 1987.



EDISON'S BOARD OF DIRECTORS (seated from left): Joan C. Hanley; Jack K. Horton; Howard P. Allen; H. Frederick Christie; William R. Gould; Camilla C. Frost. Standing from left: Edward Zapanta, M.D.; Walter B. Gerken; Roy A. Anderson; Henry T. Segerstrom; Norman Barker, Jr.; Warren Christopher; H. Russell Smith; E. L. Shannon, Jr.; Carl F. Huntsinger; James M. Rosser; J. J. Pinola.

Executive Officers

Howard P. Allen	<i>Chairman of the Board and Chief Executive Officer</i>
H. Frederick Christie	<i>President</i>
John E. Bryson	<i>Executive Vice President and Chief Financial Officer</i>
David J. Fogarty	<i>Executive Vice President</i>
Michael R. Peevey	<i>Executive Vice President</i>
P. L. Martin	<i>Senior Vice President</i>
L. T. Papay	<i>Senior Vice President</i>
Kenneth P. Baskin	<i>Vice President (Nuclear Engineering, Safety and Licensing)</i>
Glenn J. Bjorklund	<i>Vice President (System Planning and Research)</i>
Robert H. Bridenbecker	<i>Vice President (Fuel Supply)</i>
John R. Bury	<i>Vice President and General Counsel</i>
Richard K. Bushey	<i>Vice President and Controller</i>
Robert Dietch	<i>Vice President (Engineering and Construction)</i>
C. E. Hathaway	<i>Vice President (Human Resources)</i>
Charles B. McCarthy, Jr.	<i>Vice President (Customer Service)</i>
Michael L. Noel	<i>Vice President and Treasurer</i>
Harold B. Ray	<i>Vice President and Site Manager, San Onofre Nuclear Generating Station</i>
⁽¹⁾ Honor Muller	<i>Corporate Secretary</i>
⁽²⁾ Jennifer Moran	<i>Corporate Secretary</i>

⁽¹⁾Mrs. Muller retired effective December 31, 1986.

⁽²⁾Ms. Moran was elected Corporate Secretary effective January 1, 1987.

Southern California Edison Company

Distribution of Record Shareholders and Shares

as of December 31, 1986

	Shareholders				Shares			
	Preferred	%	Common	%	Preferred	%	Common	%
Total	19,473	100.0	157,695	100.0	13,984,774	100.0	216,906,527	100.0
<i>Class of Investor</i>								
Males	3,749	19.2	36,061	22.9	562,253	4.0	15,865,748	7.3
Females	8,063	41.4	54,422	34.5	1,098,217	7.9	20,392,883	9.4
Joint Accounts	4,673	24.0	43,609	27.7	894,626	6.4	18,598,049	8.6
Fiduciaries	1,885	9.7	19,861	12.6	377,111	2.7	8,946,409	4.1
Religious, Charitable, Fraternal and Educational Institutions	115	0.6	530	0.3	51,019	0.4	767,505	0.4
Financial Institutions	384	2.0	1,095	0.7	8,964,232	64.1	148,611,388	68.5
Other	604	3.1	2,117	1.3	2,037,316	14.5	3,724,545	1.7
<i>Amount of Holdings</i>								
1 to 99 shares	10,015	51.4	38,571	24.4	267,804	1.9	1,410,148	0.7
100 shares	3,343	17.2	11,236	7.1	334,300	2.4	1,123,600	0.5
101 to 499 shares	4,070	20.9	70,266	44.6	985,437	7.0	18,171,053	8.4
500 to 999 shares	1,102	5.7	20,612	13.1	658,355	4.7	13,675,930	6.3
1,000 or more shares	943	4.8	17,010	10.8	11,738,878	84.0	182,525,796	84.1
<i>Geographical Location</i>								
Service Territory	5,070	26.0	38,098	24.2	1,505,697	10.8	27,679,961	12.8
Remainder of California	6,366	32.7	45,834	29.1	3,241,642	23.2	45,823,636	21.1
United States (except California) and Possessions	7,996	41.1	73,219	46.4	9,232,464	66.0	143,173,120	66.0
Foreign Countries	41	0.2	544	0.3	4,971	0.0	229,810	0.1

1987 Annual Shareholders' Meeting:

The annual meeting of shareholders of Southern California Edison Company will be held at 10 a.m., Thursday, April 16, 1987, at the Industry Hills and Sheraton Resort, One Industry Hills Parkway, City of Industry, California 91744.

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

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.

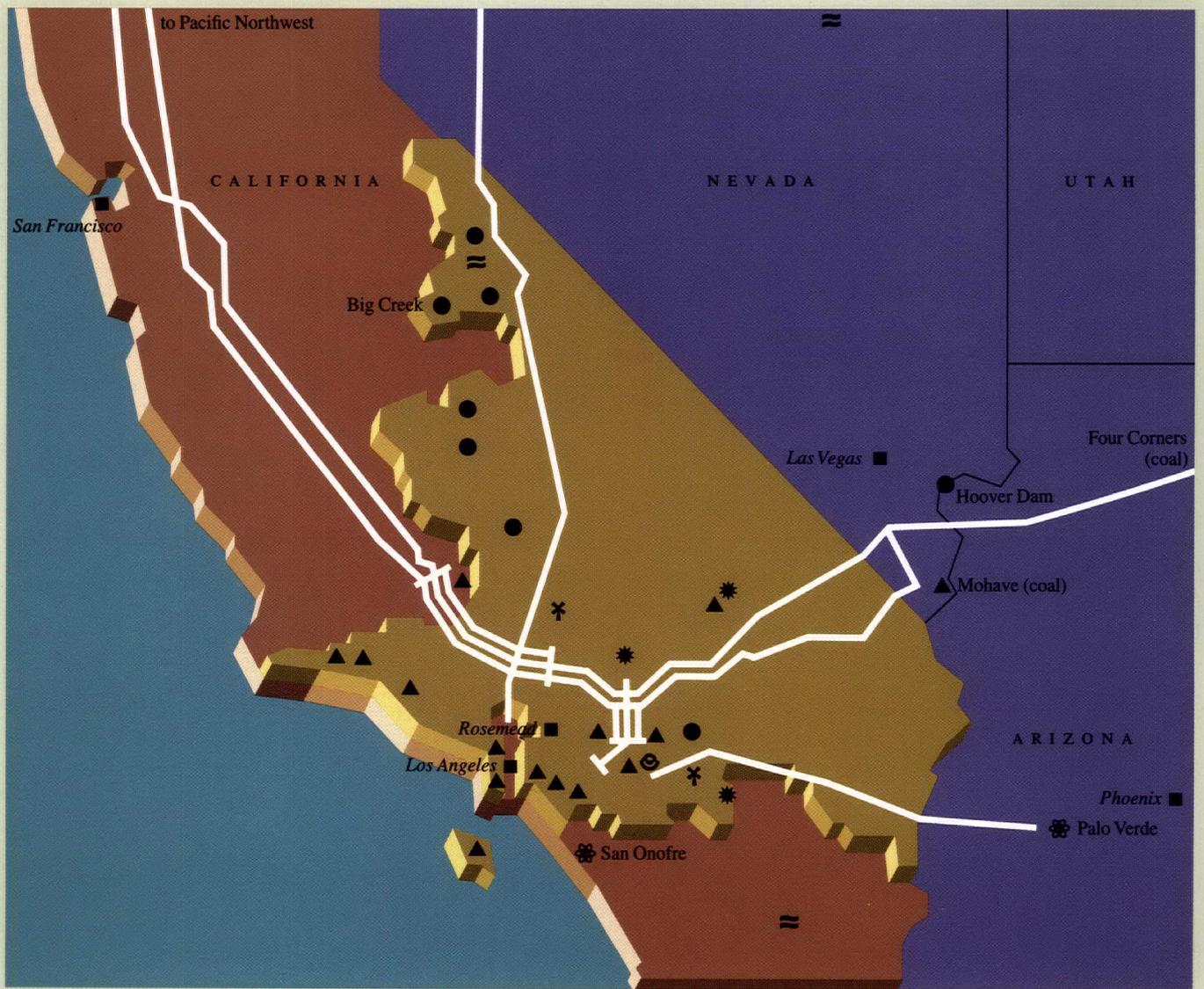
This Annual Report and the statements and statistics contained herein have been assembled for general informative purposes and are not intended to induce, or for use in connection with, any sale or purchase of securities. Under no circumstances is this report or any part of its contents to be considered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

Quarterly Financial Data

Quarterly financial information for 1986 and 1985 are reflected in the table below. The Company's common stock is traded on the New York, Pacific and London Stock Exchanges. There were approximately 158,000 common stock shareholders of record at December 31, 1986. Dividends are

declared and paid quarterly. The Indenture securing the First and Refunding Mortgage Bonds provides, in substance, that cash dividends shall not be paid except out of earnings reinvested in the business and net income.

		Operating Revenues	Operating Income	Net Income	Per Share		Stock Prices	
					Earnings	Dividends Declared	High	Low
<i>(In Millions, Except Per Share Data)</i>								
1986	First Quarter	\$1,240	\$250	\$199	\$.84	\$.54	\$31 ⁷ / ₈	\$25 ¹ / ₄
	Second Quarter	1,211	235	194	.83	.57	32 ¹ / ₈	28 ³ / ₈
	Third Quarter	1,550	267	217	.94	.57	38 ³ / ₄	30 ³ / ₈
	Fourth Quarter	<u>1,311</u>	<u>216</u>	<u>159</u>	<u>.67</u>	<u>.57</u>	36	31 ⁷ / ₈
	Total	<u>\$5,312</u>	<u>\$968</u>	<u>\$769</u>	<u>\$3.28</u>	<u>\$2.25</u>		
1985	First Quarter	\$1,217	\$251	\$201	\$.86	\$.51	\$24 ³ / ₄	\$22 ¹ / ₈
	Second Quarter	1,228	244	190	.80	.54	27 ⁷ / ₈	23 ⁵ / ₈
	Third Quarter	1,452	264	210	.89	.54	27 ⁵ / ₈	22 ³ / ₄
	Fourth Quarter	<u>1,272</u>	<u>214</u>	<u>173</u>	<u>.71</u>	<u>.54</u>	28 ¹ / ₂	22 ³ / ₄
	Total	<u>\$5,169</u>	<u>\$973</u>	<u>\$774</u>	<u>\$3.26</u>	<u>\$2.13</u>		



- Hydroelectric
- ▲ Fossil (includes coal gasification)
- ☼ Nuclear
- ≡ Geothermal
- ✦ Wind
- ★ Solar
- ⊙ Biomass
- Service territory
- Extra high voltage (EHV) transmission lines

Southern California Edison serves nearly 10 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 nearly 10 million people, includes some 800 cities and communities.

Edison's gross investment in utility plant totals approximately \$15.0 billion. Area generating capacity at peak during 1986 totaled 18,320 megawatts (MW), which included 14,709 MW of Company-owned facilities and 3,611 MW of capacity from other

sources. Of the Company-owned facilities, 68 percent was composed of oil- and gas-fired generating units. Edison's interest in nuclear and coal-fired generating units accounted for 15 percent and 11 percent, respectively, and 6 percent was in hydroelectric generation.

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 and hydroelectric development are subject to regulation by the

Federal Energy Regulatory Commission, as well as 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
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