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WILLIAM F. CONWAY
EXECUTIVE VICE PRESIDENT
NUCLEAR

161-02476-WFC/NEM
October 11, 1989

Docket Nos. STN 50-528/529/530

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Dear Sirs:

Subject: Palo Verde Nuclear Generating Station (PVNGS)
Units 1, 2 and 3
Submittal of 1988 Annual Reports
File: 89-056-026; 89-017-404

Pursuant to 10 CFR 50.71(b), please find attached, copies of 1988 Annual Reports for the Participants who jointly own the Palo Verde Nuclear Generating Station. These Participants are Arizona Public Service Company, Salt River Project Agricultural Improvement and Power District, El Paso Electric Company, Southern California Edison Company, Public Service Company of New Mexico, Southern California Public Authority and Los Angeles Department of Water and Power.

If you have any questions, please contact Mr. A. C. Rogers of my staff at (602) 371-4041.

Sincerely,

WFConway

WFC/NEM/jle

Attachments

cc: T. L. Chan (w/o attachments)
J. B. Martin (w/attachments)
M. J. Davis (w/o attachments)
T. J. Polich (w/attachments)
A. C. Gehr (w/o attachments)

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SOUTHERN CALIFORNIA EDISON COMPANY

1988 Annual Report

50-528/529/530 8910190216 10/11/89

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-NOTICE-

Southern California Edison

ANNUAL REPORT

This is the Annual Report to Preferred Shareholders of Southern California Edison Company (the Company) for the year ended December 31, 1988. This report is being provided to holders of the Company's Cumulative Preferred Stock and $100 Cumulative Preferred Stock in connection with the Annual Meeting of Shareholders to be held at 10:00 a.m. on Thursday, April 20, 1989, at the Industry Hills and Sheraton Resort, One Industry Hills Parkway, City of Industry, California. This report contains the Company's audited financial statements for the 1988 fiscal year and other information of interest to the Company's shareholders.

ABOUT THE COMPANY

The Company was incorporated in 1909 under California law and is a public utility primarily engaged in the business of supplying electric energy to a 50,000 square-mile area of central and southern California, excluding the City of Los Angeles and certain other cities. This area includes some 800 cities and communities and a population of more than ten million people. As of December 31, 1988 the Company had 16,660 employees.

On July 1, 1988, the Company became a subsidiary of a new holding company, SCEcorp. Each share of the Company's Common Stock and Original Preferred Stock was converted into Common Stock of SCEcorp. The Cumulative Preferred Stock and $100 Cumulative Preferred Stock were not affected and continue to be securities of the Company. Because all of the currently outstanding Common Stock of the Company is owned by SCEcorp, this Annual Report to Shareholders is being provided only to holders of the Company's preferred stocks.

SOUTHERN CALIFORNIA EDISON COMPANY

CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31, 1988	1987	1986
	(In thousands)		
Operating Revenue:			
Sales	$5,856,236	$5,448,663	$5,275,547
Other	76,670	53,636	43,110
Total operating revenue	5,932,906	5,502,299	5,318,657
Operating Expenses:			
Fuel	972,973	1,091,973	865,376
Purchased power	1,234,831	780,599	775,814
Provisions for regulatory adjustment clauses—net	240,681	225,108	225,539
Other operating expenses	870,995	850,447	828,672
Maintenance	375,082	361,201	352,696
Depreciation and decommissioning	644,036	549,810	506,230
Income taxes	412,105	555,433	687,520
Property and other taxes	169,405	161,618	143,321
Total operating expenses	4,920,108	4,576,189	4,385,168
Operating Income	1,012,798	926,110	933,489
Other Income and Deductions:			
Nuclear plant disallowance (Note 3)	—	(148,963)	(269,883)
Income taxes—nuclear plant disallowance	—	78,616	61,665
Provision for rate phase-in plan	170,856	137,832	88,672
Allowance for equity funds used during construction	18,125	73,406	105,744
Interest income	108,634	87,936	107,379
Taxes on nonoperating income	(76,647)	(78,306)	(35,654)
Other—net	(653)	18,688	24,368
Total other income—net	220,315	169,209	82,291
Income Before Interest Expense	1,233,113	1,095,319	1,015,780
Interest Expense:			
Interest on long-term debt and amortization	420,615	397,699	432,608
Other interest expense	107,412	80,953	82,592
Allowance for borrowed funds used during construction	(11,883)	(42,926)	(29,478)
Capitalized interest	(14,416)	(19,646)	(27,824)
Total interest expense—net	501,728	416,080	457,898
Income Before Cumulative Effect of a Change in Accounting Principle	731,385	679,239	557,882
Cumulative effect on prior years (to December 31, 1986) of accruing unbilled revenue—net of income tax of $58,752,000 (Note 2)	—	68,044	—
Net Income	731,385	747,283	557,882
Dividends on cumulative preferred and preference stock	46,696	50,095	54,684
Earnings Available for Common Stock	$ 684,689	$ 697,188	$ 503,198

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

SOUTHERN CALIFORNIA EDISON COMPANY

CONSOLIDATED BALANCE SHEETS

ASSETS

	December 31, 1988	December 31, 1987
	(In thousands)	
Utility Plant:		
Utility plant, at original cost (Note 3)	$15,687,850	$14,465,691
Less—Accumulated provision for depreciation and decommissioning (Note 3)	4,529,938	3,993,468
	11,157,912	10,472,223
Construction work in progress	676,175	1,232,990
Nuclear fuel, at amortized cost	475,764	547,786
	12,309,851	12,252,999
Less—Property-related accumulated deferred income taxes	914,532	840,143
Total utility plant	11,395,319	11,412,856
Other Property and Investments:		
Nonutility property—less accumulated provision for depreciation of $13,744,000 and $121,835,000 at respective dates	45,838	47,482
Nuclear decommissioning trusts, at cost	157,086	—
Other investments	28,978	23,483
Total other property and investments	231,902	70,965
Current Assets:		
Cash and equivalents	23,222	32,452
Receivables, including unbilled revenue, less allowances of $13,140,000 and $14,829,000 for uncollectible accounts at respective dates	690,547	615,397
Fuel stock	125,303	118,540
Materials and supplies, at average cost	96,767	105,577
Regulatory balancing accounts—net	395,026	621,635
Prepayments and other current assets	81,185	78,242
Total current assets	1,412,050	1,571,843
Deferred Charges:		
Unamortized debt issuance and reacquisition expense	296,094	301,741
Rate phase-in plan	435,941	239,760
Other deferred charges	138,593	132,040
Total deferred charges	870,628	673,541
Total assets	$13,909,899	$13,729,205

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

SOUTHERN CALIFORNIA EDISON COMPANY

CONSOLIDATED BALANCE SHEETS

CAPITALIZATION AND LIABILITIES

	December 31, 1988	December 31, 1987
	(In thousands)	
Capitalization (see accompanying statements):		
Common stock, at par value, 217,444,052 and 217,126,601 shares outstanding at respective dates	$ 906,017	$ 904,694
Additional paid-in capital	1,258,872	1,307,758
Retained earnings	2,391,703	2,329,174
Common shareholder's equity (Note 3)	4,556,592	4,541,626
Preferred and preference stock:		
Not subject to mandatory redemption	358,755	361,238
Subject to mandatory redemption	239,037	277,538
Long-term debt	5,212,657	4,915,328
Total capitalization	10,367,041	10,095,730
Other Long-Term Liabilities	136,810	113,348
Current Liabilities:		
Current portion of long-term debt and redeemable preferred and preference stock	144,917	101,555
Short-term debt	658,255	665,839
Accounts payable	436,318	481,628
Accrued taxes	435,030	471,008
Accrued interest	117,142	106,259
Dividends payable	139,187	133,281
Accumulated deferred income taxes—net	166,386	235,921
Deferred unbilled revenue and other	297,217	347,445
Total current liabilities	2,394,452	2,542,936
Deferred Credits:		
Accumulated deferred investment tax credits	507,666	525,750
Accumulated deferred income taxes—net	256,493	176,835
Customer advances and other deferred credits	247,437	274,606
Total deferred credits	1,011,596	977,191
Commitments and Contingencies (Notes 1, 3, 8, 9, and 10)		
Total capitalization and liabilities	$13,909,899	$13,729,205

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

SOUTHERN CALIFORNIA EDISON COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1988	1987	1986
		(In thousands)	
Cash Flows From Operating Activities:			
Net income	$ 731,385	$ 747,283	$ 557,882
Adjustments for noncash items:			
Depreciation and decommissioning	644,036	549,810	506,230
Amortization	147,875	156,980	129,800
Nuclear plant disallowance—net	—	70,347	208,218
Allowance for funds used during construction	(30,008)	(116,332)	(135,222)
Rate phase-in plan	(196,181)	(149,110)	(90,650)
Regulatory deferrals—energy exploration projects	—	61,637	21,748
Deferred income taxes and investment tax credits	104,574	143,978	266,430
Other—net	(5,834)	22,439	8,391
Changes in working capital components:			
Receivables	(75,150)	(252,403)	(18,343)
Regulatory balancing accounts	226,609	(31,548)	17,120
Fuel stock, materials and supplies	2,047	133,518	3,214
Prepayments and other current assets	(2,943)	(3,723)	29,159
Accrued interest and taxes	(63,242)	8,384	222,263
Accounts payable and other current liabilities	(95,538)	284,631	48,733
	1,387,630	1,625,891	1,774,973
Cash Flows From Financing Activities:			
Issuances of long-term debt	622,684	132,548	1,428,675
Repayments of long-term debt	(328,412)	(275,026)	(1,595,936)
Redemption of preferred and preference stock	(48,775)	(17,712)	(200,525)
Nuclear fuel financing	(18,569)	(56,191)	(46,518)
Short-term debt financings—net	58,416	175,810	232,240
Capital transfers and dividend payments	(716,450)	(643,463)	(553,389)
	(431,106)	(684,034)	(735,453)
Cash Flows From Investing Activities:			
Construction expenditures	(817,025)	(1,021,177)	(1,156,387)
Contributions to decommissioning funds	(157,086)	—	—
Other—net	8,357	5,635	15,297
	(965,754)	(1,015,542)	(1,141,090)
Decrease in cash and equivalents	(9,230)	(73,685)	(101,570)
Cash and equivalents, beginning of year	32,452	106,137	207,707
Cash and equivalents, end of year	$ 23,222	$ 32,452	$ 106,137
Noncash Investing and Financing Activities:			
Conversion of 5.20% convertible preference stock	$2,108	$ 414	$ 845
Conversion of subordinated debentures	2,973	3,136	2,849

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

SOUTHERN CALIFORNIA EDISON COMPANY

CONSOLIDATED STATEMENTS OF CAPITALIZATION

				December 31, 1988	December 31, 1987
				(In thousands)	
COMMON SHAREHOLDER'S EQUITY (See accompanying statements)				$ 4,556,592	$ 4,541,626
PREFERRED AND PREFERENCE STOCK—					
		December 31, 1988			
Not subject to mandatory redemption(b)(c):	Series	Shares Outstanding	Redemption Price		
Cumulative preferred:					
$25 Par Value:	4.08%	1,000,000	$ 25.50	25,000	25,000
	4.24	1,200,000	25.80	30,000	30,000
	4.32	1,653,429	28.75	41,336	41,336
	4.78	1,296,769	25.80	32,419	32,419
	5.80	2,200,000	25.25	55,000	55,000
$100 Par Value:	7.58	750,000	101.00	75,000	75,000
	8.70	500,000	104.00	50,000	50,000
	8.96	500,000	104.00	50,000	50,000
Preference:					
$25 Par Value:	5.20 convertible	—	—	—	2,483
Total				358,755	361,238
Subject to mandatory redemption(b)(d):					
Cumulative preferred:					
$100 Par Value:	7.325%	547,381	$103.54	54,738	60,000
	7.80	483,495	104.62	48,350	51,000
	8.54	615,000	105.65	61,500	63,750
	8.70A	433,124	110.00	43,312	45,937
	12.31	430,000	105.83	43,000	50,000
Preference:					
$25 Par Value:	7.375	—	—	—	28,864
				250,900	299,551
Preferred and preference stock to be redeemed within one year				(11,863)	(22,013)
Total				239,037	277,538
LONG-TERM DEBT—					
First and refunding mortgage bonds(d)(e):					
	Maturity		Interest Rates		
	1989 through 1992		4⅜% to 8¾%	475,000	672,000
	1993 through 1997		6⅜% to 9%	1,125,000	1,000,000
	1998 through 2002		8¼% to 9%	650,000	500,000
	2003 through 2007		9⅝% to 9.95%	278,750	284,000
	2008 through 2020		8⅜% to 13%	1,267,476	1,084,413
				3,796,226	3,540,413
Pollution control bonds(d)(f):	1999 through 2015		6¾% to 10¾% and variable	947,730	897,730
Funds held by trustees				(11,119)	(10,472)
Debentures and notes(c)(d):	1992 through 1993		9.6% to 11%	211,550	202,973
Nuclear fuel indebtedness(d)(g)				424,168	379,029
Long-term debt due within one year(d)				(133,054)	(79,542)
Unamortized debt discount—net				(22,844)	(14,803)
Total				5,212,657	4,915,328
Total Capitalization				$10,367,041	$10,095,730

Notes to Consolidated Statements of Capitalization are on the following page.
The accompanying notes are an integral part of these financial statements.

Notes to Consolidated Statements of Capitalization

(a) Effective July 1, 1988, SCEcorp became the parent holding company of Southern California Edison Company (the Company). Holders of the Company's common stock became holders of SCEcorp common stock on a share-for-share basis. The California Public Utilities Commission's (CPUC) decision authorizing establishment of a holding company requires the Company to maintain a capital structure consistent with the CPUC's most recently authorized capital structure.

(b) In connection with the formation of SCEcorp, each outstanding share of the Company's original preferred stock was converted into 2.1 shares of SCEcorp's common stock. The Company's authorized shares of $25 cumulative preferred, $100 cumulative preferred, $25 preference and $100 preference stock are 24,000,000, 12,000,000, 10,000,000, and 2,000,000 shares, respectively. All series of cumulative preferred and preference stock are redeemable. The 430,000 shares of $100 cumulative preferred stock, 12.31% Series, are not subject to redemption until May 1, 1992 other than pursuant to sinking fund provisions. The various series of $100 cumulative preferred stock are subject to certain restrictions on redemption for refunding purposes.

(c) On May 31, 1988, the Company either redeemed or converted its outstanding shares of 5.20% convertible preference stock and converted all of the outstanding 12½% convertible debentures at the conversion price of $16.1875.

(d) The table below presents the mandatory redemption requirements for preferred stock, long-term debt maturities and sinking fund requirements for the five years subsequent to December 31, 1988:

	Year Ended December 31,				
	1989	1990	1991	1992	1993
	(In thousands)				
Preferred stock redemption requirements	$ 11,863	$ 11,738	$ 11,738	$ 11,738	$ 12,338
Long-term debt maturities and sinking fund requirements	133,054	182,858	174,674	192,088	212,541
Total	$144,917	$194,596	$186,412	$203,826	$224,879

(e) Substantially all the Company properties are subject to the liens of trust indentures, except for nuclear fuel and fuel oil inventories, which are financed with short-term debt in conformity with CPUC ratemaking procedures.

(f) First and refunding mortgage bonds and other indebtedness have been issued to governmental agencies in exchange for proceeds from pollution control bonds. These proceeds have been deposited with trustees and are used to finance construction of pollution control facilities. Certain pollution control bonds may be redeemed at the discretion of bondholders. The Company has made arrangements with security dealers for the remarketing or purchase of the pollution control bonds in such cases. The Company arranged lines of credit for $600 million at December 31, 1988, to refinance these bonds, should remarketing be unsuccessful.

(g) Nuclear fuel financing is comprised of:

	December 31,	
	1988	1987
	(In thousands)	
Foreign-currency-denominated notes(1)	$ 62,950	$ 66,000
Commercial paper(2)	338,777	288,296
Spent nuclear fuel obligation(3)	22,441	24,733
	424,168	379,029
Less: Current maturities	65,494	2,292
Total	$358,674	$376,737

(1) The Company issued foreign-currency-denominated notes totaling $60.4 million in September 1987 to finance nuclear fuel. The notes mature 24 months from the date of issuance. Under a currency-exchange agreement, a securities firm assumes all foreign-currency translation gains and losses. Weighted-average interest rates on the notes are based on the average daily commercial paper rate and were 7.46% for 1988 and 7.09% for 1987. Foreign-currency translation gains or losses have been deferred and are included in the translated value of the liability.

(2) A portion of the commercial paper used to finance nuclear fuel has been classified as long-term debt under refinancing agreements with commercial banks. The long-term portion finances nuclear fuel not scheduled for consumption within 12 months of the balance sheet dates.

(3) Pursuant to the Nuclear Waste Policy Act of 1982, the Company has signed a contract with the U.S. Department of Energy for disposal of spent nuclear fuel from the San Onofre Nuclear Generating Station. The interest rate is fixed at 10.57%.

SOUTHERN CALIFORNIA EDISON COMPANY

CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDER'S EQUITY

	1988	1987	1986
	Year Ended December 31, (In thousands)		
Common Stock—par value $4⅙ per share, 280,000,000 shares authorized, 217,444,052, 217,126,601, and 216,906,527 outstanding at respective dates(a)(b)	$ 906,017	$ 904,694	$ 903,777
Additional Paid-In Capital:			
Balance at beginning of year	$1,307,758	$1,402,217	$1,431,041
Premium received on capital stock, conversions and redemptions(b)	4,635	2,608	2,664
Capital stock expense	(21)	(24)	(56)
Capital transfer prior to restructuring and other	(53,500)	(97,043)	(31,432)
Balance at end of year	$1,258,872	$1,307,758	$1,402,217
Retained Earnings:			
Balance at beginning of year	$2,329,174	$2,132,694	$2,107,228
Add:			
Net income	731,385	747,283	557,882(c)
	3,060,559	2,879,977	2,665,110
Less:			
Dividends declared on:			
Common	622,160	513,367	489,909
Cumulative preferred	46,208	47,730	51,311
Preference	488	2,365	3,062
	668,856	563,462	544,282
Other — net	—	12,659	11,866
Balance at end of year(d)	$2,391,703	$2,329,174	$2,132,694
Total Common Shareholder's Equity at End of Year	$4,556,592	$4,541,626	$4,438,688

(a) As a result of the corporate restructuring described in Note 1 of Notes to Consolidated Financial Statements, all issued and outstanding common stock is now held by SCEcorp and is no longer publicly traded.

(b) During the second quarter of 1988, common stock was issued for the conversion of most of the outstanding 5.20% Convertible Preference Stock and all of the 12½% Convertible Subordinated Debentures, Due 1997. The outstanding shares of 5.20% Convertible Preference Stock that were not converted were redeemed.

(c) Restated from $751,088,000 to $557,882,000 to reflect the after-tax write-off of nuclear plant disallowances totaling $193,206,000. (See Note 3 of Notes to Consolidated Financial Statements).

(d) Includes appropriated retained earnings related to certain federally licensed hydroelectric projects of $4,468,000 at December 31, 1988.

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

SOUTHERN CALIFORNIA EDISON COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—Corporate Restructuring and Proposed Merger

On July 1, 1988, SCEcorp acquired the outstanding common stock of Southern California Edison Company (the Company) under a merger agreement approved by shareholders on April 21, 1988. The Company's common shareholders became holders of SCEcorp's common stock on a share-for-share basis. Each share of the Company's outstanding original preferred stock was converted into 2.1 shares of SCEcorp's common stock. The Company's remaining preferred stock and debt securities were not exchanged or transferred to SCEcorp. The Company's equity investment in nonutility subsidiaries was transferred to SCEcorp at book value on July 1, 1988. The accompanying consolidated financial statements have been restated to reflect the financial position and results of operations of the Company as presently structured. The effect on net income of excluding the earnings of nonutility companies that were formerly the Company's subsidiaries is reflected in the table below.

	Year Ended December 31,	
	1987	1986
	(In thousands)	
Net income previously reported	$788,626	$768,617
Restatement—nuclear plant disallowance (Note 3)	—	(193,206)
Earnings from nonutility subsidiaries	(41,343)	(17,529)
Restated net income	$747,283	$557,882

On November 30, 1988, SCEcorp, the Company, and San Diego Gas & Electric Company (SDG&E) executed an agreement to merge SDG&E into the Company. Under the terms of the merger agreement, SCEcorp will exchange 1.3 shares of its newly issued common stock for each SDG&E common share. SDG&E preferred and preference stock will be exchanged for SCEcorp preferred and preference stock with similar provisions, except that dividends on each series will be increased between 2.5% and 20.0%. The merger is subject to approval by the shareholders of SCEcorp, the Company, and SDG&E, as well as regulatory agencies, including the California Public Utilities Commission (CPUC) and the Federal Energy Regulatory Commission (FERC).

NOTE 2—Summary of Significant Accounting Policies

Consolidation Policy—

The consolidated financial statements include the accounts of the Company, its wholly owned financing subsidiary, SCE Capital Company, and other utility related subsidiaries which are not considered significant for financial reporting purposes. All significant intercompany transactions have been eliminated, except intercompany profits from energy sales to the Company by unregulated, energy-producing affiliates, which are allowed in rates.

Accounting Principles—

The Company is regulated by the CPUC and the FERC. The accompanying consolidated financial statements reflect the ratemaking policies of these commissions, as applied to the Company, in conformity with generally accepted accounting principles applicable to rate-regulated enterprises.

Utility Plant—

The costs of plant additions, including replacements and betterments, are capitalized and included in utility plant. Capitalized costs include direct material and labor, construction overhead, and an allowance for debt and equity funds used to finance construction. The cost of property that is replaced or retired—and related removal costs, less salvage—is charged to the accumulated provision for depreciation. Accumulated deferred income taxes related to utility plant are presented as a deduction from utility plant to conform with ratemaking procedures used to determine rate base.

NOTE 2—Summary of Significant Accounting Policies—(continued)

Allowance for Funds Used During Construction (AFUDC)—

AFUDC represents the cost of debt and equity funds that finance construction of utility plant. Capitalized AFUDC is reported in the consolidated statements of income as a reduction of interest charges for the debt component and as other income for the equity component. AFUDC and plant construction costs are recovered when completed projects are placed into commercial operation, and the recovery of related depreciation is authorized through customer rates.

Before 1987, the cost of debt included in the AFUDC calculation was reduced by the tax benefit realized from deducting the related interest expense from taxable income. As a result of changes in the treatment of interest expense for income tax purposes, pretax interest expense was used to compute the debt component of AFUDC beginning in 1987. The AFUDC rate, which reflects semiannual compounding, was 10.76% for 1988 and 11.57% for 1987 under the pretax method. The rate was 10.53% for 1986 under the previous net-of-tax method.

Depreciation and Decommissioning—

Depreciation of utility plant, except nuclear fuel, is computed on a straight-line, remaining-life basis.

The estimated cost of decommissioning the Company's nuclear generating facilities is $713 million and is recovered in rates through annual allowances charged to depreciation expense. Retail rates for 1988, and certain prior years, included annual decommissioning revenue requirements, which have been deposited in trust funds until decommissioning begins. Trust fund contributions are invested in high-grade securities. Approximately 80% of the trust fund contributions qualify as tax deductions.

Nuclear Fuel—

The cost of nuclear fuel, including its disposal, is amortized on the basis of generation and is charged to fuel expense. In accordance with ratemaking procedures adopted by the CPUC, nuclear fuel financing costs are capitalized until the fuel is placed into production.

Research, Development, and Demonstration (RD&D)—

RD&D costs not related to a specific project are expensed in the year incurred. RD&D costs related to specific construction projects are capitalized until it is determined whether they will result in construction of plant. If construction does not result, the costs are charged to expense.

RD&D costs are reflected in the following table:

	Year Ended December 31,		
	1988	1987	1986
		(In thousands)	
RD&D costs charged to expense	$43,414	$42,893	$47,122
RD&D costs deferred/capitalized	17,455	14,855	3,888
Total RD&D costs	$60,869	$57,748	$51,010

Commencing in 1988, a balancing account has been established for RD&D costs charged to expense. Under this mechanism, the Company is required to refund to ratepayers any authorized but unspent RD&D funds at the end of the three-year rate-case cycle ending December 31, 1990.

Unamortized Debt Issuance and Reacquisition Expense—

Debt premium, discount, and issuance expenses are amortized over the lives of the related issuances. The expense of reacquiring bonds that are redeemed without refunding are amortized over the period the debt would have remained outstanding. The reacquisition expenses are amortized over the lives of the new debt issues when debt is reacquired with refunding.

NOTE 2—Summary of Significant Accounting Policies—(continued)

Change in Accounting Principle—

Prior to 1987, electric operating revenue was recorded based on customer billings. On January 1, 1987, the Company began accruing estimated revenue for electricity that had been delivered to customers through the end of each month but had not yet been billed. This accounting change conforms to the Tax Reform Act of 1986, which requires utilities to include unbilled revenue in taxable income commencing in 1987 and results in a better matching of revenue and expense.

Had the new accounting method been in effect for 1986, net income would have been $2.7 million less than the amount reported.

Regulatory Balancing Accounts—

Operating Revenue—

The CPUC has authorized an electric revenue adjustment mechanism (ERAM) balancing account to minimize the effect on earnings of retail sales fluctuations. Differences between authorized and recorded base rate revenue are accumulated in the account until they are refunded to or recovered from utility customers through CPUC-authorized rate adjustments.

Energy Costs—

An energy cost adjustment clause (ECAC) balancing account adjusts results of operations for variations between the recorded cost of fuel and purchased power and revenue designated for recovery of such costs. Undercollected energy costs are accumulated in the balancing account until they are recovered from utility customers through CPUC-authorized rate adjustments. Previously, 90% of fuel and purchased power costs were recovered through ECAC, and the remaining 10% of such costs were recovered through the annual energy rate (AER). On June 1, 1988, the CPUC suspended the AER rate component. As a result, all fuel and purchased power costs are currently recovered through ECAC.

In 1987, the CPUC authorized a one-time write-down of the cost of fuel oil inventory to market prices. It also authorized the last-in, first-out inventory method for measuring the cost of fuel oil consumption. The $108.7-million write-down, including interest, has been recorded in the ECAC balancing account. On December 31, 1988, the balance remaining to be recovered was $59.0 million, including interest.

The CPUC has established performance incentives based on target generation levels for the Company's nuclear generating stations. Fuel savings or costs attributable to levels above or below the targeted ranges are divided equally between the Company and customers through adjustments to the ECAC balancing account.

Major Plant Additions—

Before 1988, the Company used major additions adjustment clause (MAAC) balancing accounts to accumulate the differences between revenue required to provide recovery of ownership costs of San Onofre Nuclear Generating Station (San Onofre) Units 2 and 3 and Palo Verde Nuclear Generating Station (Palo Verde) Units 1 and 2 and related authorized revenue.

Commencing in 1988, ownership costs of San Onofre Units 2 and 3 are recovered in base rates. The ownership costs of Palo Verde Units 1, 2, and 3 are also recovered in base rates to the extent they are not deferred in accordance with the Palo Verde rate phase-in plan. Recovery of remaining undercollections in the MAAC balancing accounts as of December 31, 1988, has been authorized over a three-year period, beginning in 1989.

NOTE 2—Summary of Significant Accounting Policies—(continued)

Interest and Taxes—

Interest on regulatory balancing accounts is accrued at the three-month prime commercial paper rate. The weighted-average interest rates were 7.60% for 1988 and 6.57% for 1987. Income tax effects on the changes in the regulatory balancing accounts are deferred.

Palo Verde Rate Phase-In Plan—

Palo Verde Units 1, 2, and 3 have been in commercial operation, for ratemaking purposes, since February 1, 1986, September 19, 1986, and January 20, 1988, respectively. The CPUC has adopted a 10-year rate phase-in plan, which defers $200 million of required revenue during the first four years of operation for each unit. Deferrals for each unit, for years one through four, are $80 million, $60 million, $40 million, and $20 million, respectively. The deferrals and related interest will be recovered on a level basis during the final six years of each unit's phase-in plan.

Statements of Cash Flows—

Beginning in 1988, the Company presented statements of cash flows in conformity with a new accounting standard. Prior periods have been restated to be consistent with the current presentation. For purposes of the consolidated statements of cash flows, the Company considers short-term temporary cash investments to be cash equivalents. Cash payments for interest were $468.2 million in 1988, $452.6 million in 1987, and $465.7 million in 1986.

Restatements and Reclassifications—

All prior period financial statements and related notes have been restated to reflect consolidation of all majority-owned subsidiaries. The consolidated financial statements also have been restated to reflect the write-off of utility plant and related adjustments to the accumulated provision for depreciation, accumulated deferred income taxes, and retained earnings resulting from the CPUC's disallowance of nuclear plant construction costs. See Note 3 for a further discussion of the disallowance.

Certain other items in prior periods have also been reclassified to conform them to the financial statement presentations for December 31, 1988.

NOTE 3—Regulatory Matters

CPUC Disallowances—

In October 1986, the CPUC disallowed $258.6 million of the Company's $3.4-billion investment in San Onofre Units 2 and 3. The Company filed for rehearing on $213.4 million of the disallowed costs in December 1986. In March 1987, the CPUC granted a rehearing on indirect construction cost issues and, in July 1987, issued a decision that reduced the October 1986 disallowance to $198.9 million.

Recovery of the Company's $1.5-billion investment in Palo Verde was reduced by 19.33% of the amount disallowed for San Onofre Units 2 and 3, under a ratemaking agreement adopted by the CPUC. The CPUC's investment disallowances for San Onofre and Palo Verde total $237 million.

In December 1986, the Financial Accounting Standards Board began requiring regulated enterprises to write off construction costs not allowed in rate base. The new standard provides for the restatement of prior period financial statements for disallowances occurring before the standard's effective date of January 1, 1988. Accordingly, the 1986 consolidated statement of income includes a one-time, after-tax charge against earnings of approximately $193 million, reflecting the CPUC's final construction-cost disallowances arising from its October 1986 decision.

NOTE 3—Regulatory Matters—(continued)

In addition, revenue accrued to recover prior years' ownership costs, which is associated with the construction costs disallowed by the CPUC, has been written off from the MAAC balancing account. The Company recorded after-tax charges against earnings of approximately $15 million for 1986 and $70 million for 1987.

Energy Cost Proceedings—

The CPUC's Division of Ratepayer Advocates (DRA) recommended that the CPUC disallow $124 million of energy costs incurred between late 1984 and late 1987. Approximately $120 million of the proposed disallowance represents alleged overpayments to nonutility power producers, including electricity purchased by the Company from a 300-MW cogeneration facility owned by Kern River Cogeneration Company (KRCC). Mission Energy Company, which is one of SCEcorp's nonutility subsidiaries, is a partner in the KRCC facility. The DRA's proposed disallowance in relation to power purchases from KRCC is approximately $37 million. In upcoming CPUC hearings, the Company will demonstrate that the power purchases from KRCC actually saved its customers more than $24 million during the three years under consideration, compared with the "standard offer" contract approved by the CPUC. The DRA also alleges overpayments by the Company under 17 other contracts negotiated with nonutility power producers that are not SCEcorp affiliates. The Company signed these contracts during the early stages of California's efforts to rapidly develop alternate and renewable energy resources. At that time the projected prices under these 17 contracts were at or below avoided cost standard contracts over their lives.

In addition to its recommended energy cost disallowance, the DRA has recommended that the CPUC modify its early 1988 decision that authorized formation of a holding company.

Although the probable effect that the outcome of this matter will have on net income cannot be determined at this time, the Company believes that adoption of the DRA's recommendation to modify the holding company decision is not necessary to protect the public interest and will work diligently to demonstrate that it has reasonably administered the contracts under review. CPUC proceedings are scheduled to take place later this year.

Resale Rates—

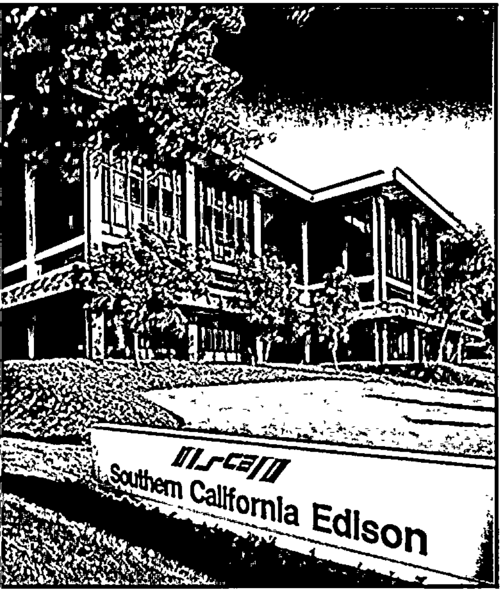
In accordance with FERC procedures, resale revenue is subject to refund with interest if subsequently disallowed. The Company believes that any refunds resulting from pending rate proceedings, should not have a material effect on net income.

NOTE 4—Short-Term Debt

The Company maintains unrestricted deposits of approximately $7 million at commercial banks and pays annual commitment fees of up to .1% to maintain lines of credit which may be utilized at negotiated or bank index rates and which totaled $1.9 billion on December 31, 1988. Approximately $1.3 billion of these lines of credit support commercial paper and other borrowings to finance general cash requirements; fuel inventories; and undercollections in regulatory balancing accounts. The remaining $600 million of these lines of credit are available for the long-term refinancing of certain variable-rate pollution-control indebtedness.

SCEcorp

NYSE: SCE



In 1988, SCEcorp was formed as the parent holding company of Southern California Edison Company, and The Mission Group of nonutility businesses. The formation of SCEcorp provides a better corporate separation between utility and nonutility businesses.

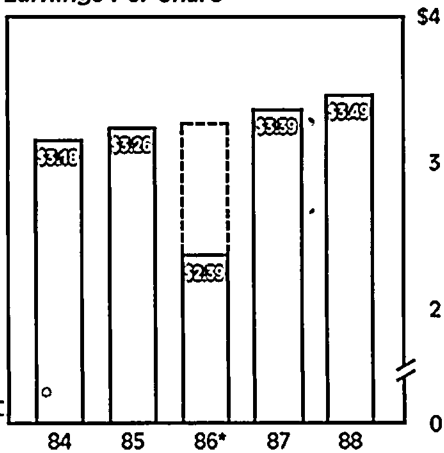
The Boards of Directors of SCEcorp and San Diego Gas & Electric Company (SDG&E) reached agreement to merge SDG&E into Edison. Shareholders approved the merger, and it is expected to be completed during 1990, subject to state and federal regulatory approvals.

SCEcorp is well positioned for the future with a financially and operationally strong electric utility in a growing service territory, and nonutility subsidiaries with good prospects for earnings growth.

Strong Financial Performance

- ▲ SCEcorp achieved another year of record earnings per share.
- ▲ Nonutility earnings per share increased 84% from 1987, providing 10% of SCEcorp earnings, with earnings growth achieved in each nonutility business.
- ▲ Nonutility earnings rank second among all electric utilities and electric utility holding companies.
- ▲ Dividends have been paid without interruption since incorporation in 1909 and increased 13 times in the past 12 years.
- ▲ Total return to shareholders (stock price appreciation plus dividends) averaged more than 19% for the past five-year and ten-year periods.
- ▲ 100% of Edison's capital needs were generated internally in 1988, the highest level in over 30 years.
- ▲ Bond ratings have been maintained at double-A (very strong) from both Standard & Poor's and Moody's since initial ratings.

Earnings Per Share



*Reflects a one-time restatement for nuclear plant disallowance.

May 1989

SCEcorp Financial Highlights

	1988	1987	1986	1985	1984
Operating Revenues (millions)	$6,253	$5,602	$5,368	$5,217	$4,899
Net Income (millions)	$762	$739	$521*	$702	$659
Rate of Return on Common Equity	15.3%	15.5%*	11.1%*	15.8%	16.3%
Earnings Per Share	$3.49	$3.39	$2.39*	$3.26	$3.18
Dividends Paid Per Common Share	$2.43	$2.33	$2.22	$2.10	$1.97
Stock Price — Year End	$32⅜	$30½	$33⅞	$26⅝	$22¾
Dividend Yield	7.7%	7.8%	6.7%	8.1%	9.0%

* Reflects a one-time restatement for nuclear plant disallowance.

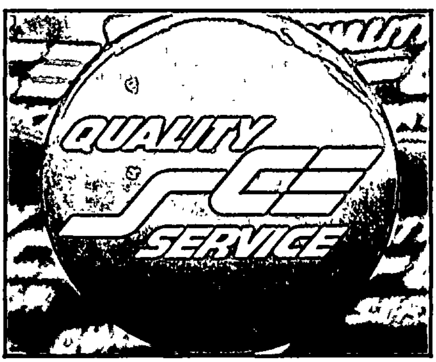
SCEcorp's

Utility Subsidiary

Southern California Edison

Southern California Edison

Edison, the second largest U.S. electric operating utility, serves more than 3.8 million customers in a 50,000-square-mile service territory that covers much of Central and Southern California. With headquarters in Rosemead, California, Edison is a regulated, investor-owned utility providing electric service to one of the nation's most robust and properous regional economies.



Strong Customer Growth

In 1988, Edison added over 114,000 new customers, the third highest customer growth in its 102-year history.

The growth and vitality of Edison's service territory contributes to its strong financial position. Edison's service territory contains four of the five fastest growing counties in California and, if a separate nation, would have the 15th largest economy of any country in the world.

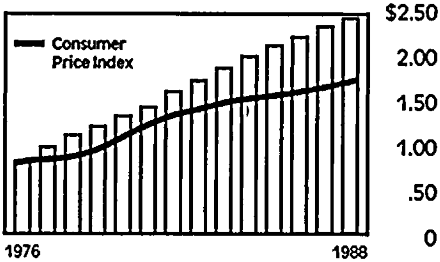
Quality Customer Service

A key element of the company's approach to customers is a strong commitment to excellent service. Last year alone, companywide quality service programs found literally hundreds of ways to give better and more responsive service to customers. Quality service results in customer satisfaction and ultimately benefits shareholders.

Dividends

In June 1988, SCEcorp raised its common stock dividend 4.2% from $2.38 to $2.48 per share. This was the 13th dividend increase in the past 12 years. At year-end 1988, the annual dividend provided a 7.7% yield on a common stock market price of $32⅜ per share.

SCEcorp Dividend History

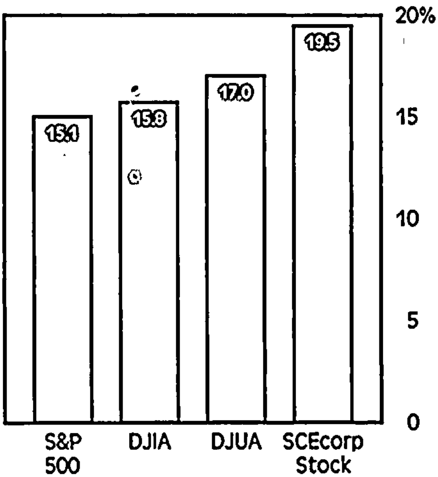


SCEcorp Stock Data

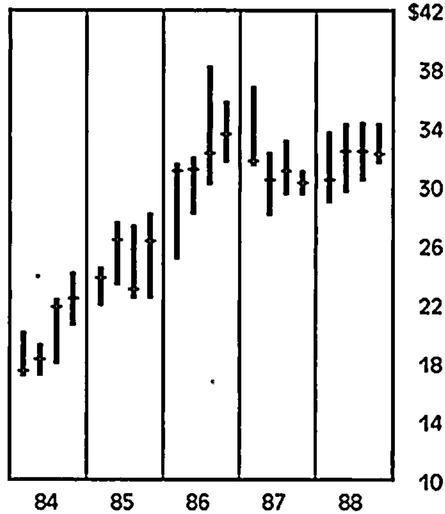
Common stock is traded under the symbol SCE on the New York, Pacific, London, and Tokyo exchanges. SCEcorp's newspaper listing symbol is SCEcp. Average daily volume in the U.S. for 1988 was 825,000 shares. Unusually large volume in December 1987 and June 1988 resulted from dividend trading strategies.

SCEcorp Five-Year Annual Return Comparison

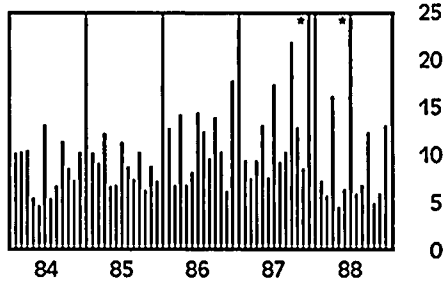
(Stock Appreciation and Dividends)



SCEcorp Stock Price and Volume History



(Millions of Shares)



*See SCEcorp Stock Data.

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SCEcorp

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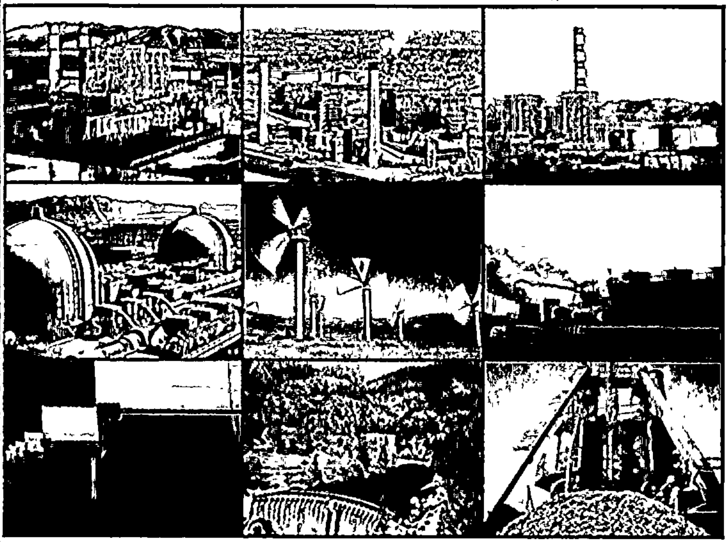
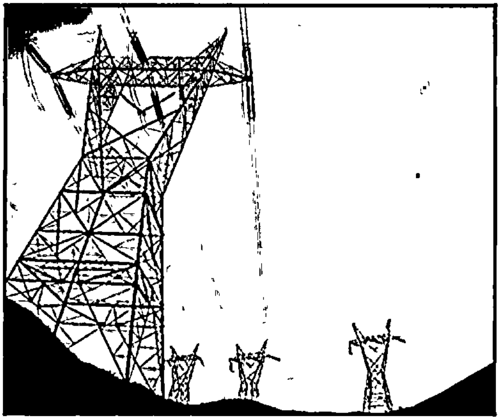


Diversified Resources

The company maintains a significant degree of flexibility by utilizing nine different energy resources to produce electricity — gas, oil, coal, nuclear, wind, geothermal, solar, hydro, and biomass — more resources than any other utility in the world.

Expanding Transmission Access

Edison's transmission system includes five major transmission lines, three lines to the Pacific Northwest and two lines to the Southwest. These lines are capable of transmitting 4,000 MW to Edison or enough power to serve two million people. A recent upgrade to one line and planned construction of two additional lines will increase the company's transmission capacity 25%. These transmission facilities enhance system reliability and provide greater access to low-cost, out-of-state surplus energy and capacity.



Leader in Research and Development

Edison continues to be a leader in research and development. Current projects include participation in the development of a revolutionary new two-way electronic metering and communications network and promotion of pollution-free electric vehicle development.

SCEcorp's

Nonutility Subsidiaries

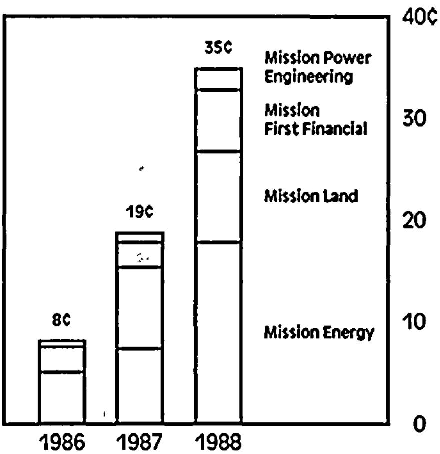
The Mission Group

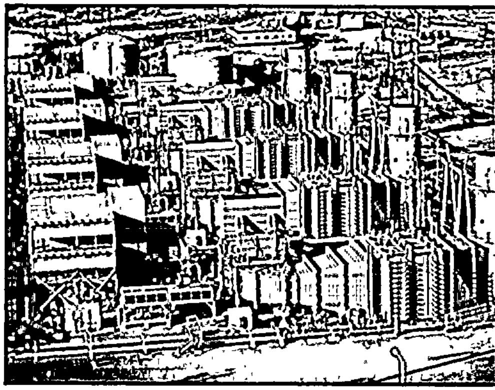
MISSION ENERGY	MISSION FIRST FINANCIAL	MISSION LAND	MISSION POWER ENGINEERING

The Mission Group

In 1987, the Mission Group was established to consolidate and manage SCEcorp's nonutility businesses. Its objective is to broaden SCEcorp's earnings base by investing in areas which can provide long-term earnings growth. The Mission Group's four nonutility subsidiaries are in businesses closely related to the electric industry including: development and ownership of cogeneration and independent power production facilities, financial investments, real estate development, and engineering and construction of electric power generating facilities and transmission systems.

The Mission Group Earnings Per Share

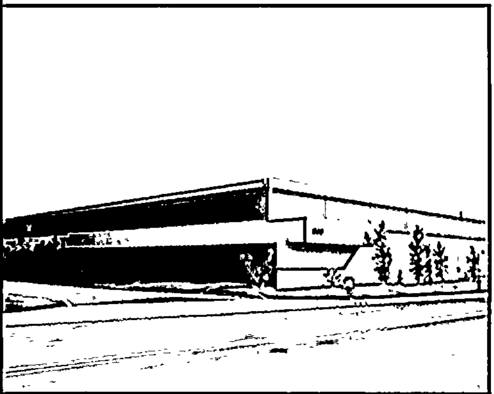




Mission Energy

Formed in 1986, Mission Energy has already established itself as a national leader in the ownership, development, and operation of alternative energy resources. Mission Energy provides a cost-effective solution to the generating needs of the 1990s and beyond.

Mission Energy's projects consist largely of cogeneration installations over 100 MW in size and emphasize joint venture projects with low technological risk, sound economics, and strong contractual relationships with well-established partners. Mission Energy is presently a partner in projects totalling almost 2,000 megawatts, or enough energy to serve the needs of more than one million people.



Mission Land

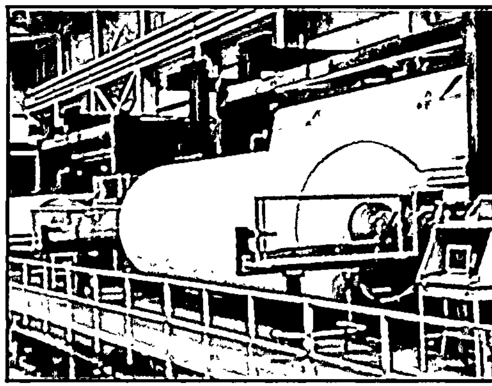
Mission Land was formed in 1986 with its predecessor companies dating back to the early 1900s. Its principal business is development of industrial warehouses and distribution buildings.

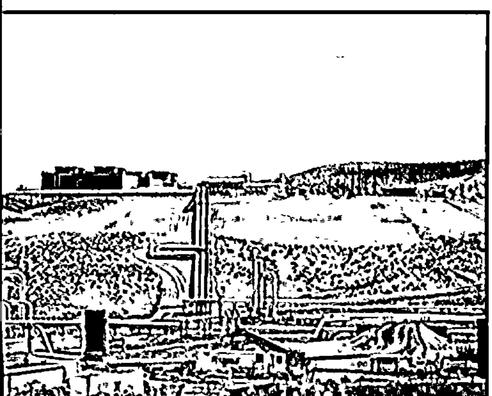
Mission Land owns and manages six industrial parks in separate regions in Southern California and Arizona, which contain more than two million square feet of leasable space. Additionally, Mission Land has entered into several joint-venture land developments in Illinois, Indiana, and California.

Mission First Financial

Formed in 1987, Mission First Financial engages in longer-term, financially-oriented investment opportunities such as high-quality securities, leverage leasing, project financing, and energy-related venture capital.

Mission First Financial participated in a sale and leaseback of a nuclear power plant in Pennsylvania and a paper mill/cogeneration plant in Minnesota. Mission First Financial is also managing a hedged utility-oriented dividend capture program.





Mission Power Engineering

Formed in 1986, Mission Power Engineering performs consulting, engineering and construction including electric generating units, transmission lines, and substations.

Mission Power has been awarded contracts with a total value of more than $400 million. This subsidiary has grown steadily and last year ranked 26th among the nation's top 500 engineering/design firms.

NOTE 4—Short-Term Debt—(continued)

The Company's short-term debt is comprised of:

	December 31, 1988	December 31, 1987
	(In millions)	
General purpose	$ 67.1	$ 35.8
Balancing accounts	400.0	400.0
Fuel	535.3	518.3
Total borrowings supported by lines of credit	1,002.4	954.1
Less: Amount reclassified as long-term	338.8	288.3
Unamortized discount	5.3	—
Net short-term debt	$ 658.3	$665.8

NOTE 5—Income Taxes

The Company and its subsidiaries are included in SCEcorp's consolidated federal income tax and combined state franchise tax returns. Under income tax allocation agreements, each affiliate calculates its tax liability separately.

Current and Deferred Taxes—

Income tax expense includes the current tax liability 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.

The current and deferred components of income tax expense are:

	Year Ended December 31, 1988	1987	1986
	(In thousands)		
Current:			
Federal	$278,598	$395,064	$349,034
State	105,580	121,075	117,177
	384,178	516,139	466,211
Deferred—federal and state:			
Investment and energy tax credits—net	(18,085)	(15,824)	61,737
Depreciation	149,249	172,710	170,594
Regulatory balancing accounts	(79,460)	(33,463)	(21,400)
Debt reacquisition expenses	(2,507)	(1,390)	81,968
Fuel contract settlements	(1,980)	16,002	9,528
Nuclear plant disallowance	—	(78,616)	(61,665)
Cumulative effect of accounting change	—	58,752	—
Capitalized exploration and development expenses	—	—	(31,338)
Unbilled revenue	(24,420)	(27,467)	—
Rate phase-in plan	78,743	68,797	46,398
Fixed charges	7,994	(14,178)	(45,538)
Contributions in aid of construction	(28,836)	(14,000)	—
Other	23,876	(33,587)	(14,986)
	104,574	97,736	195,298
Total income tax expense	$488,752	$613,875	$661,509
Classification of income taxes:			
Included in operating expenses	$412,105	$555,433	$687,520
Included in other income	76,647	78,306	35,654
Nuclear plant disallowance	—	(78,616)	(61,665)
Related to cumulative effect of accounting change	—	58,752	—
Total income tax expense	$488,752	$613,875	$661,509

NOTE 5—Income Taxes—(continued)

Accumulated deferred investment tax credits are amortized over the lives of the related properties.

Cash payments for income taxes were $500.8 million in 1988, $497.1 million in 1987, and $311.8 million in 1986.

The following table reconciles the differences between recorded state and federal income taxes and amounts determined on income before taxes by applying the federal statutory tax rate. The federal and composite federal and state statutory income-tax rates are 34% and 40.138%, respectively, for 1988; 40% and 46.138%, respectively, for 1987; and 46% and 51.184%, respectively, for 1986.

	Year Ended December 31,		
	1988	1987	1986
		(In thousands)	
Expected federal income tax expense at statutory rate	$ 414,847	$ 544,463	$ 560,920
Increase (decrease) in income tax expense resulting from:			
Allowance for equity and borrowed funds used during construction	(6,163)	(29,362)	(62,202)
Federal deduction for state taxes on income	(35,886)	(47,046)	(53,208)
Depreciation timing difference not deferred	70,224	96,042	102,536
State tax provision	105,547	117,614	115,669
Prior years' decommissioning	(15,714)	—	—
Nuclear plant disallowance	—	(4,730)	55,042
All other differences	(44,103)	(63,106)	(57,248)
Total income tax expense	$ 488,752	$ 613,875	$ 661,509
Pretax income	$1,220,137	$1,361,158	$1,219,391
Effective tax rate (total income tax expense ÷ pretax income)	40.1%	45.1%	54.2%

Deferred income taxes for tax depreciation prior to 1981 and certain construction overheads have not been provided because the tax effects of such timing differences are not allowed for retail ratemaking purposes until the taxes become payable. The cumulative net amount of these timing differences was $1.8 billion on December 31, 1988, and 1987.

Ratemaking Investigation—

In 1986, the CPUC began an investigation to evaluate the effects of the Tax Reform Act of 1986 on ratemaking procedures. Revenue for recovery of income tax expense for 1987 and subsequent periods was collected subject to refund pending a CPUC decision.

In October 1988, the Company refunded approximately $51 million through the ERAM balancing account, in compliance with an August 1988 CPUC interim resolution. Final CPUC approval of the amounts refunded is pending. Because the Company had previously provided a reserve for this item, refunds to customers have not and are not expected to have any significant effect on net income.

New Accounting Standard—

Under accounting rules currently in effect, deferred income tax balances are not adjusted to reflect changes in tax law or rates. However, a new accounting standard will require such adjustments beginning in 1990.

The new standard requires significant balance sheet adjustments. The Company will record additional deferred income taxes related to the equity component of AFUDC, which is currently recorded on an after-tax basis; the debt component of AFUDC, which was recorded on a net-of-tax

NOTE 5—Income Taxes—(continued)

basis prior to 1987; and other temporary differences for which deferred income taxes have not been provided.

Additional balance sheet adjustments will be recorded for the net reduction in deferred income tax liabilities resulting from income tax rate changes; the recognition of deferred income tax assets attributable to the reduction of the book basis of property by unamortized investment tax credits; and to classify property-related accumulated deferred taxes as a liability instead of a reduction of utility plant.

The majority of additional deferred-tax assets and liabilities will be offset by recording regulatory assets and liabilities representing the anticipated effects of these adjustments on customer rates. Such regulatory assets and liabilities will be adjusted as they are recovered or refunded through the ratemaking process and for changes in tax rates or laws.

NOTE 6—Employee Benefit Plans

Pension Plan—

The Company has a trusteed noncontributory defined-benefit pension plan, covering substantially all full-time employees who fulfill minimum service requirements. Benefits are based on years of accredited service and average compensation. The Company's policy is to fund the plan on a level premium actuarial method, provided that annual contributions meet the minimum funding requirements of the Employee Retirement Income Security Act and do not exceed the maximum deductible amount under income tax regulations. Prior service costs from pension plan amendments are funded over 30-year periods.

In 1987, a new accounting standard for defined-benefit plans was implemented that changed the basis for determining pension expense. Before 1987, pension cost was based on the actuarial method used to determine annual contributions to the plan. For 1986, pension expense amounted to $48.6 million.

Pension expense under the new standard includes the following components:

	Year Ended December 31, 1988	1987
	(In thousands)	
Net pension expense:		
Service cost for benefits earned	$ 43,340	$ 46,629
Interest cost on projected benefit obligation	102,249	91,025
Actual return on plan assets	(133,687)	(130,723)
Net amortization and deferral	40,610	46,699
Pension liability pursuant to accounting standards	52,512	53,630
Regulatory adjustment	(6,416)	(3,481)
Net pension cost recognized	$ 46,096	$ 50,149

In conformity with the accounting principles for rate-regulated enterprises, regulatory adjustments have been recorded to reflect, in net income, the pension costs calculated under the actuarial method used for ratemaking purposes. The difference between pension costs calculated for accounting and ratemaking purposes has been recorded as a deferred charge on the consolidated balance sheets.

NOTE 6—Employee Benefit Plans—(continued)

The plan's funded status is presented below:

	December 31, 1988	December 31, 1987
	(In thousands)	
Actuarial present value of benefit obligations:		
Vested benefits	$ 905,190	$ 800,952
Nonvested benefits	68,531	57,306
Accumulated benefit obligation	973,721	858,258
Value of projected future compensation levels	435,363	372,095
Projected benefit obligation	$1,409,084	$1,230,353
Plan assets at fair value	$1,326,635	$1,201,550
Benefit obligation in excess of plan assets	$ (82,449)	$ (28,803)
Unrecognized net gain	(49,021)	(101,562)
Unrecognized net obligation being amortized over 17 years	89,640	95,163
Accrued pension liability	$ (41,830)	$ (35,202)
Assumptions for defined benefit pension plan:		
Discount rate	8.0%	8.5%
Rate of increase in future compensation	6.0%	6.0%
Expected long-term rate of return on assets	8.5%	8.5%

Assets of the plan consist primarily of common stocks, corporate and government bonds, short-term investments, and guaranteed investment contracts.

Employee Stock Plans—

The Company maintains an Employee Stock Ownership Plan (ESOP) and a Stock Savings Plus Plan (SSPP), designed to supplement employees' retirement income. Contributions to the ESOP were funded primarily by federal income tax benefits and contributions by employees. Company contributions to the SSPP were $16.9 million in 1988, $16.6 million in 1987, and $15.4 million in 1986.

Other Post-Employment Benefits—

Health care and life insurance are provided for retired employees and their dependents. Group life insurance is provided through an insurance company. Health care is provided by a combination of Company facilities and insurance programs. The costs of these benefits for retirees were $22.8 million in 1988, $18.0 million in 1987, and $15.4 million in 1986.

NOTE 7—Jointly Owned Utility Projects

The Company owns undivided interests in several generating stations and transmission systems, for which each participant provides its own financing. The proportionate share of expenses pertaining to such projects is included in the appropriate operating expense category in the

NOTE 7—Jointly Owned Utility Projects—(continued)

consolidated statements of income. The table below presents the investments in each project as included in the consolidated balance sheet as of December 31, 1988:

	(In thousands)			
	Plant in Service	Accumulated Depreciation	Under Construction	Ownership Interest
El Dorado Transmission System	$ 21,649	$ 8,590	$ 108	60.00%(a)
Four Corners Coal Generating Station—Units 4 and 5	401,142	122,613	11,395	48.00
Mohave Coal Generating Station	233,708	95,919	877	56.00
Pacific Intertie DC Transmission System	115,047	34,075	69,550	50.00
Palo Verde Nuclear Generating Station	1,463,307	80,810	8,348	15.80
San Onofre Nuclear Generating Station:				
Unit 1	537,022	153,999	23,261	80.00
Units 2 and 3	2,759,741	477,523	18,084	75.05
Common facilities—Units 2 and 3	819,030	114,846	1,863	75.05
Common facilities—Units 1, 2, and 3	176,130	28,854	3,599	75.87
Yuma Axis Generating Station	12,369	10,516	69	33.30
Total	$6,539,145	$1,127,745	$137,154	

(a) Represents a composite rate.

NOTE 8—Leases

The Company leases automotive, computer, office, and miscellaneous equipment through operating rental agreements with varying terms, provisions, and expiration dates. At December 31, 1988, estimated remaining rental commitments for noncancelable operating leases were as follows:

Year Ended December 31,	(In thousands)
1989	$ 28,284
1990	25,227
1991	22,354
1992	18,926
1993	14,637
For periods thereafter	16,266
Total future rental commitments	$125,694

On June 10, 1987, a wholly owned subsidiary purchased the leasing company from which the Company leased its nuclear fuel, by assuming the leasing company's commercial paper obligations. On March 1, 1988, the Company assumed the commercial paper obligations of the affiliated nuclear fuel lessor and terminated the nuclear fuel lease agreement. Lease liabilities supported by commercial paper borrowings, which had been classified as long-term obligations, have been reclassified as long-term debt to conform with the financial statement presentation of nuclear fuel financing on December 31, 1988. The long-term debt amount represents the estimated repayment of commercial paper based upon expected nuclear fuel consumption subsequent to one year after the balance sheet date and is supported by refinancing agreements with commercial banks.

NOTE 9—Commitments

Construction Program and Fuel Supply—

As of December 31, 1988, the Company's construction expenditures are estimated to be $802 million for 1989, $704 million for 1990, and $713 million for 1991. In addition, minimum long-term commitments of approximately $1,607 million existed as of December 31, 1988, under fuel supply contracts.

NOTE 9—Commitments—(continued)

Long-Term Purchased Power and Transmission Contracts—

The Company has contracted to purchase portions of the generating output of certain facilities and to purchase firm transmission service when appropriate. Although there is no investment in such facilities, these contracts provide for minimum payments based, in part, on the debt service requirements of the provider, whether or not the facility or transmission line is operable. None of these power contracts provide, or are expected to provide, more than 5% 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 consolidated statements of income. Purchased power costs are generally recoverable through the ECAC balancing account procedure. Selected information pertaining to these contracts on December 31, 1988, is summarized as follows:

	Purchased Power	Transmission Service
Years contracts expire	1990-2017	1990-2016
Share of effective operating capacity—megawatts	473.5-627.5	
Share of energy output	5.54%-100.0%	
Required minimum annual payments	(In thousands)	
1989	$ 46,468	$ 9,033
1990	13,854	6,030
1991	2,500	4,529
1992	2,500	4,422
1993	2,500	4,267
Thereafter	59,375	86,118
Total	$127,197	$114,399

Purchased power costs were $121.5 million in 1988, $118.0 million in 1987, and $115.3 million in 1986. Transmission costs were $11.4 million in 1988, $11.2 million in 1987, and $12.0 million in 1986.

NOTE 10—Contingencies

Nuclear Insurance—

On August 22, 1988, Congress amended the Price-Anderson Act, extending it until August 1, 2002. It increased—to $7.6 billion from $720 million—the limit on public liability claims that could arise from a nuclear incident. Participants in San Onofre and Palo Verde have purchased the maximum private primary insurance available, which currently is $200 million. The balance is to be covered by the industry's retrospective rating plan, using deferred premium charges. This secondary level of financial protection is required by the Nuclear Regulatory Commission (NRC). The maximum amount of the deferred premium that may be charged for each nuclear incident is $63 million per reactor, but not more than $10 million per reactor may be charged in any one year for each incident. The Company could be required to pay a maximum of $183.6 million per nuclear incident, on the basis of its ownership interests in San Onofre and Palo Verde, but it would have to pay no more than $29.1 million per incident in any one year. Such amounts include a 5% surcharge that would be applicable in the event that additional funds are needed to satisfy public liability claims, and are subject to adjustment for inflation.

Property damage insurance covers losses up to $500 million at San Onofre and Palo Verde. Decontamination liability and property damage coverage in excess of the primary $500 million layer has also been purchased, exceeding NRC requirements. Insurance covering part of the additional expense of replacement power, which could result from an accident related nuclear unit outage, is also provided. After the first 21 weeks of such an outage, a maximum weekly indemnity of $2.7 million for a single unit for 52 weeks begins. An additional $1.4 million per week is provided for the

NOTE 10—Contingencies—(continued)

next 52 weeks. These policies are issued primarily by 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 $54.0 million per year. Insurance premiums are charged to operating expenses.

Antitrust Litigation—

In 1978, five resale customers filed a suit in federal district court, alleging violation of antitrust laws. The complaint seeks monetary damages, a trebling of such damages, and certain injunctive relief. The complaint alleges that the Company engaged in anticompetitive behavior by charging more for electricity it sold to resale customers than it charged certain classes of retail customers. The complaint also alleges that the Company acted 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. The plaintiffs estimate that their actual damages, before trebling, were approximately $99.5 million from February 1, 1978, through December 31, 1985. The trial began on July 8, 1986, and concluded on September 26, 1986. The Company filed findings of fact and conclusions of law with the court on November 21, 1986. A decision is pending.

In 1983, another resale customer also filed a suit in federal district court, alleging violation of certain antitrust laws. The customer alleges that it has been denied access to lower-cost power and was overcharged for power purchases as well as other operational and financial damages. On July 17, 1988, the Company received the customer's antitrust damage study alleging total damages of approximately $135 million before trebling. A trial date of November 14, 1989, has been set.

The foregoing proceedings involve complex issues of law and fact. Although the Company is unable to predict the final outcome, it has categorically denied the resale customers' allegations.

SOUTHERN CALIFORNIA EDISON COMPANY

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

RESULTS OF OPERATIONS

Earnings Summary

Earnings available for common stock in 1988 decreased $12.5 million or 1.8% compared to the prior year. The decrease is primarily attributable to the reduction in the California Public Utilities Commission's (CPUC) authorized rate of return on common equity from 13.9% in 1987 to 12.75% in 1988. Several items offset the negative impact of the CPUC's reduction in authorized return on common equity, including the CPUC's approval of non-fuel expense levels that more accurately reflect current operating costs, management's continued emphasis on cost containment and a CPUC award for favorable coal-plant operating performance.

Operating Revenue and Sales

Approximately 98% of operating revenue represents retail sales that are subject to rate regulation by the CPUC. The remaining revenue is from sales to wholesale customers, which are regulated by the Federal Energy Regulatory Commission (FERC).

Operating revenue increased by $430.6 million, or 7.8%, over last year, reflecting a 3.6% increase in kilowatt-hour sales. The increase in revenue is attributable to a 3.9% increase in retail sales volume that resulted from the addition of more than 114,000 new customers and the effect of rate changes. Resale sales volume declined 5.4% due to the availability of alternative energy sources to resale customers. Increases in operating revenue of 3.4% in 1987 and 2.6% in 1986 reflect, in addition to rate changes, a 5.1% retail sales volume increase in 1987 and a 1.2% sales volume decline in 1986.

The table below presents the changes in major components of operating revenue which contributed to the overall variation from prior years.

	Increase (Decrease) From Prior Years December 31,		
	1988	1987	1986
	(In Millions)		
Operating Revenue— Sales			
Base rate changes	$664.8	$ (6.5)	$ 61.8
Balancing account rate changes	(456.9)	30.2	97.9
Sales volume changes—Retail	206.2	255.6	91.3
Sales volume changes—Resale	(6.5)	(106.3)	(117.2)
Other	23.0	10.6	3.0
Total	$430.6	$183.6	$136.8

Rate changes that became effective January 1, 1989, are projected to increase revenue by $77.7 million, or 1.3%. The CPUC approved an attrition increase of $116.4 million to recognize increases in nonfuel expenses and to increase the Company's authorized rate of return on common equity to 13.0% from 12.75%. In separate proceedings, the CPUC authorized a $77.1-million rate decrease after the Company completed full recovery of uranium contract settlement payments and granted a $38.4 million rate increase for additional plant investment in the San Onofre Nuclear Generating Station.

Operating Expenses

Operating expenses for 1988 increased by $343.9 million, or 7.5%, over 1987, compared with increases of $191.0 million, or 4.4% in 1987, and $173.8 million, or 4.1% in 1986. Fuel expense declined $119.0 million, or 10.9% in 1988, compared with an increase of $226.6 million in 1987, and a decrease of $812.4 million in 1986. The reduction in fuel expense for 1988 is the result of increased nuclear generation which displaced higher cost natural gas generation. The Company operated higher cost non-nuclear fuel-burning power plants less because of an increase in mandatory purchases of power from nonutility producers at CPUC-mandated rates that exceeded rates for economy purchases. Purchased power expense increased by $454.2 million, or 58.2%, over 1987. The effect on earnings of fuel and purchased power cost fluctuations is minimized by regulatory adjustment mechanisms established by the CPUC and the FERC.

Provisions for regulatory adjustment clauses for 1988 reflect net overcollections of $240.7 million. The overcollections are attributable to growth in kilowatt-hour sales; CPUC-authorized recovery of previously deferred energy costs through the Energy Cost Adjustment Clause; and amortization of deferred costs under an adjustment clause that was established to recover costs of major system additions.

System growth, including the addition of the Balsam Meadow Hydro Project, which commenced commercial operation in December 1987, and Palo Verde Nuclear Generating Station (Palo Verde) Unit 3, which was placed into commercial operation in January 1988, contributed significantly to the increase of $20.5 million in other operating expenses.

Depreciation and decommissioning expense increased during 1988 by $94.2 million of which $84.8 million is attributed to higher levels of decommissioning expense authorized by the CPUC. The remainder of the increase results from increased depreciation due to system growth, as described above.

Taxes on operating income for 1988 decreased $143.3 million, compared to 1987 resulting primarily from lower corporate tax rates instituted by the Tax Reform Act of 1986. However, the lower tax rates were offset by reduced electricity rates for customers and, therefore, had little or no effect on net income.

Other Income and Income Deductions

Utilities capitalize an allowance for funds used during construction (AFUDC) which represents the cost of debt and equity capital used to finance construction of plant additions. Completion of the Balsam Meadow Hydro Project and Palo Verde Unit 3 contributed significantly to a $86.3 million decline in AFUDC compared to 1987. AFUDC has declined steadily over the past three years, as the construction of major projects has been completed and the facilities placed into service.

The $20.7 million increase in 1988 interest income over 1987, resulted from higher interest rates on invested cash and increases in the average amounts of cash investments and regulatory-asset balances.

Significant Accounting Changes

In accordance with changes in accounting standards for rate-regulated enterprises, in the first quarter of 1988 the Company recorded a noncash write-off against income of approximately $193 million, net of related income tax effects, for disallowed costs on its investment in nuclear facilities. As permitted by the new accounting standard, the Company adopted these changes by restating the financial results for 1986, the period in which the write-offs would have been recorded had the present accounting rules been in effect.

As discussed further in Note 5 of the Notes to Consolidated Financial Statements, major balance sheet adjustments will be recorded in accordance with new income tax accounting requirements that become effective in 1990. These changes are not expected to significantly affect future earnings.

FINANCIAL CONDITION

Liquidity and Capital Resources

The Company's liquidity is affected primarily by construction expenditures and by capital requirements relating to debt and capital stock maturities. The capital resources available to meet these requirements include internal cash generation and external financings.

The majority of the Company's capital requirements continue to be met by cash generated through operations. For 1988, nearly 75% of cash requirements were internally generated, compared with approximately 89% in 1987 and 97% in 1986. The decline in 1988 is attributed to a 24.1% reduction in cash from operations net of a 9.4% decrease in cash requirements. Cash flow and liquidity for 1988 were unfavorably affected by revenue deferred to future years under the Palo Verde Rate Phase-in Plan, which will increase through 1990, and decline in subsequent years. Additional items impacting cash flow unfavorably are increased income tax payments resulting from the Tax Reform Act of 1986, and contributions of more than $157 million to nuclear decommissioning trusts related to 1988 and certain prior years. A decline in construction expenditures and the recovery of balancing account undercollections partially offset these adverse factors.

The Company raised $622.7 million through long-term debt issuances during 1988, primarily to finance the redemption of more costly debt, repay bond maturities, and to meet sinking fund requirements. Market conditions and other factors, including limitations imposed by the Company's Articles of Incorporation and Trust Indenture, influence external financings. As of December 31, 1988, the Company could issue approximately $3.8 billion of additional first and refunding mortgage bonds or approximately $1.7 billion of preferred stock at current interest and dividend rates under its Trust Indenture and Articles of Incorporation.

In conformity with CPUC-ratemaking procedures, short-term borrowings are utilized primarily to finance fuel-oil inventory, regulatory balancing account undercollections, and nuclear fuel. The principal and interest related to these special purpose short-term borrowings are recovered through regulatory balancing-account mechanisms. Note 4 of "Notes to Consolidated Financial Statements" discusses available lines of credit and related short-term borrowings.

Capital Requirements

The Company's primary capital requirements consist of expenditures under its construction program and debt and capital stock maturities. It is anticipated that the majority of these capital requirements will be financed through internally generated cash with supplemental financing through the issuance of long-term debt.

The following table presents the Company's projected capital requirements for calendar years 1989 through 1993:

	1989	1990	1991	1992	1993
			(In Millions)		
Construction expenditures	$802.5	$703.5	$712.9	$760.1	$694.2
Maturities of long-term debt	133.0	182.9	174.7	192.1	212.5
Redemptions of preferred stock	11.9	11.7	11.7	11.7	12.3
Capital requirements	$947.4	$898.1	$899.3	$963.9	$919.0

Capital Structure

The Company's capital structure as of December 31, 1988 is reflected in the table below:

Common equity	43.9%
Preferred stock	5.8
Long-term debt	50.3
Total	100.0%

Proposed Merger

As discussed in Note 1 of Notes to Consolidated Financial Statements, on November 30, 1988, SCEcorp, the Company, and San Diego Gas & Electric Company (SDG&E) executed an agreement to merge SDG&E into the Company. Under the terms of the merger agreement, SCEcorp will exchange 1.3 shares of its newly issued common stock for each SDG&E common share. SDG&E preferred and preference stock will be exchanged for SCEcorp preferred and preference stock with similar provisions, except that dividends on each series will be increased between 2.5% and 20.0%.

The merger is subject to the approval of shareholders and various regulatory agencies, including the CPUC and the FERC. The Company is working to complete the approval process in early 1990.

SOUTHERN CALIFORNIA EDISON COMPANY

Quarterly Financial Data
(In millions)

	1988*				
	First	Second	Third	Fourth	Total
Operating Revenue	$1,305	$1,315	$1,876	$1,437	$5,933
Operating Income	186	210	433	184	1,013
Net Income	120	141	363	107	731
Earnings Available for Common Stock	108	130	351	96	685
Common Dividends Declared	130	136	135	221	622

	1987				
	First	Second	Third	Fourth	Total
Operating Revenue	$1,286	$1,333	$1,491	$1,392	$5,502
Operating Income	209	245	248	224	926
Net Income	165**	194	215	173	747
Earnings Available for Common Stock	153	181	202	161	697
Common Dividends Declared	124	129	130	130	513

* Quarterly fluctuations compared to 1987 are primarily the result of a December 1987 CPUC rate decision which ordered the Company to change the way it bills large customers, concentrating a larger percentage of these customers' annual charges into the summer months.

** Includes $68 million resulting from an accounting change. (See Note 2 of Notes to Consolidated Financial Statements.)

RESPONSIBILITY FOR FINANCIAL REPORTING

The management of Southern California Edison Company (the Company) is responsible for preparing the accompanying consolidated financial statements. The statements were prepared in accordance with generally accepted accounting principles and include amounts based on management's estimates and judgments. Management also is responsible for the accuracy of all other information in the annual report, including its consistency with the financial statements.

The Company's consolidated financial statements have been audited in accordance with generally accepted auditing standards by Arthur Andersen & Co., a firm of independent public accountants, which has expressed its opinion regarding the fairness of these consolidated financial statements in the accompanying report.

The management of the Company maintains systems of internal control that provide reasonable assurance that assets are safeguarded, transactions are properly executed in accordance with management's authorization, and accounting records may be relied upon for the preparation of financial statements and other financial information. The design of internal control systems involves management's judgment concerning the relative cost and expected benefits of specific control measures. These systems are augmented by internal audit programs through which the adequacy and effectiveness of internal controls, policies and procedures are evaluated and reported to management. In addition, Arthur Andersen & Co., as part of its audit of the Company's consolidated financial statements, evaluate the internal control structure to determine the nature, timing and extent of its audit tests. Management believes the Company's systems of internal control are adequate to accomplish the objectives discussed herein.

The Audit Committee of the Board of Directors, composed entirely of nonemployee directors, meets periodically with the independent public accountants, internal auditors and management. This committee, which recommends to the Board of Directors the annual appointment of the independent public accountants, also considers the audit scope and nature of other services provided, discusses the adequacy of internal controls, reviews financial reporting issues and is advised of management's actions regarding these matters. Both the independent public accountants and internal auditors have unrestricted access to the Audit Committee.

Management also is responsible for fostering a climate in which the Company's affairs are conducted in accordance with the highest standards of personal and corporate conduct. This high ethical standard is reflected in the Company's Standards of Conduct, which are distributed periodically to all employees of the Company. The Standards of Conduct address, among other things, complying with all laws and regulations applicable to the Company's business, avoiding potential conflicts of interests, and maintaining the confidentiality of proprietary information. The management of the Company maintains programs to assess compliance with these standards.

John E. Bryson

JOHN E. BRYSON
Executive Vice President and
Chief Financial Officer

HOWARD P. ALLEN
Chairman of the Board,
President and
Chief Executive Officer

February 6, 1989

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

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

We have audited the accompanying consolidated balance sheets and statements of capitalization of Southern California Edison Company (a California corporation hereinafter referred to as the "Company") and its subsidiaries as of December 31, 1988 and 1987, and the related consolidated statements of income, common shareholder's equity and cash flows for each of the three years in the period ended December 31, 1988. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company and its subsidiaries as of December 31, 1988 and 1987, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1988, in conformity with generally accepted accounting principles.

As discussed in Notes 1 and 2 to the accompanying financial statements, the Company has given retroactive effect to the July 1, 1988 corporate restructuring which established it as a subsidiary of SCEcorp and to its change in the method of accounting for its majority-owned subsidiaries. Also, as discussed in Notes 2 and 3 to the financial statements, the Company changed its method of accounting for unbilled revenues as of January 1, 1987 and, effective January 1, 1988, has retroactively changed its method of accounting for disallowances of plant costs.

Arthur Andersen & Co.

ARTHUR ANDERSEN & CO.

Los Angeles, California
February 6, 1989

SOUTHERN CALIFORNIA EDISON COMPANY

SELECTED FINANCIAL AND OPERATIONAL DATA 1984-1988

	Year Ended December 31,				
	1988	1987	1986*	1985	1984**
			(In thousands)		
Summary of Operations					
Total operating revenue	$ 5,932,906	$ 5,502,299	$ 5,318,657	$ 5,181,830	$ 4,899,152
Total operating expenses	4,920,108	4,576,189	4,385,168	4,211,369	3,932,527
Fuel and purchased power expenses	2,207,804	1,872,572	1,641,190	2,383,497	2,084,941
Income taxes	412,105	555,433	687,520	714,726	639,875
Allowance for equity and borrowed funds used during construction	30,008	116,332	135,222	157,694	194,787
Total interest expense — net	513,611	459,006	487,376	498,097	530,322
Net income	731,385	747,283	557,882	765,811	732,428
Earnings available for common stock	684,689	697,188	503,198	694,113	659,385
Financial rate of return on common equity*.	14.88%	15.32%	11.07%	15.93%	16.50%
Ratemaking rate of return on common equity — earned	12.20%	11.97%	12.42%	13.22%	14.24%
Ratemaking rate of return on common equity — authorized	12.75%	13.90%	14.60%	16.00%	16.00%
Ratio of earnings to fixed charges	3.21	3.38	3.30	3.76	3.38
Balance Sheet Data					
Total assets*	$13,909,899	$13,729,205	$13,439,611	$13,092,936	$11,906,508
Gross utility plant*	16,839,789	16,246,467	15,370,139	14,541,307	13,382,809
Accumulated provision for depreciation and decommissioning*	4,529,938	3,993,468	3,555,071	3,152,141	2,763,651
Percent of gross utility plant	26.9%	24.6%	23.1%	21.7%	20.7%
Common shareholder's equity*	$ 4,556,592	$ 4,541,626	$ 4,438,688	$ 4,445,090	$ 4,246,788
Preferred and preference stock:					
—not subject to mandatory redemption	358,755	361,238	361,654	462,500	463,258
—subject to mandatory redemption	239,037	277,538	299,049	395,074	422,286
Long-term debt	5,212,657	4,915,328	5,078,378	5,175,617	4,722,079
Capital structure:					
Common shareholder's equity*	43.9%	45.0%	43.6%	42.4%	43.1%
Preferred and preference stock					
—not subject to mandatory redemption	3.5	3.6	3.6	4.4	4.7
—subject to mandatory redemption	2.3	2.7	2.9	3.8	4.3
Long-term debt*	50.3%	48.7%	49.9%	49.4%	47.9%
Operating and Sales Data					
Area peak demand (MW)	15,987	14,775	14,599	14,587	15,189
Area generating capacity at peak (MW)	18,893	18,206	18,320	17,776	17,354
Total energy requirement (KWH)(000)	75,823,860	74,142,513	73,208,697	73,755,963	72,431,625
Percent energy requirement:					
Thermal	61.9%	70.8%	55.6%	58.7%	54.1%
Renewable/alternative (including hydro)	4.0	4.7	7.9	6.0	7.5
Purchased power and other sources	34.1%	24.5%	36.5%	35.3%	38.4%
Kilowatt-hour sales (000)	67,885,761	65,539,481	64,197,405	64,984,566	63,310,047
Average annual KWH sales per residential customer	6,264	6,117	5,999	6,099	6,147
Customers	3,831,656	3,717,262	3,589,414	3,490,325	3,400,182
Employees	16,660	17,086	17,553	17,182	16,844

* Restated for nuclear plant construction cost disallowances described in Notes to Consolidated Financial Statements.

** Amounts for 1984 represent the unconsolidated financial data of the Company prior to restructuring.

COMPANY DIRECTORS

Howard P. Allen	*Chairman of the Board, President and Chief Executive Officer, SCEcorp and the Company*
Roy A. Anderson	*Chairman Emeritus, Lockheed Corporation, Burbank, California*
Norman Barker, Jr.	*Chairman of the Board, Pacific American Income Shares, Inc., Los Angeles, California*
Warren Christopher	*Chairman, O'Melveny & Myers, Los Angeles, California*
Camilla C. Frost	*Chairman of the Executive Committee, Los Angeles County Museum of Art, Los Angeles, California*
Walter B. Gerken	*Chairman of the Executive Committee, Pacific Mutual Life Insurance Company, Newport Beach, California*
William R. Gould	*Chairman Emeritus and Consultant to the Company (Retired Chairman of the Board and Chief Executive Officer of the Company), Long Beach, California*
Joan C. Hanley	*General Partner and Manager, Miramonte Vineyards, Temecula, California*
Jack K. Horton*	*Chairman of the Executive Committee, SCEcorp and the Company, and Consultant to the Company (Retired Chairman of the Board and Chief Executive Officer of the Company), Los Angeles, California*
Carl F. Huntsinger	*General Partner, DAE Limited Partnership, Ltd. (Agricultural Management), Ojai, California*
Charles D. Miller	*Chairman of the Board and Chief Executive Officer, Avery International Corporation (Manufacturer of Self-Adhesive Products), Pasadena, California*
J. J. Pinola	*Chairman of the Board and Chief Executive Officer, First Interstate Bancorp, Los Angeles, California*
James M. Rosser	*President, California State University, Los Angeles, Los Angeles, California*
Henry T. Segerstrom	*Managing Partner, C. J. Segerstrom & Sons (Real Estate Development), Costa Mesa, California*
E. L. Shannon, Jr.	*President, Chief Executive Officer and Director, Santa Fe International Corporation (Oil Service, Engineering, Petroleum Exploration and Production), Alhambra, California*
Robert H. Smith	*President and Chief Executive Officer, Security Pacific National Bank, and Vice Chairman of the Board, Security Pacific Corporation, Los Angeles, California*
Edward Zapanta	*Physician and Neurosurgeon, Monterey Park and East Los Angeles, California*

* Will not stand for re-election in 1989

COMPANY EXECUTIVE OFFICERS

Howard P. Allen	*Chairman of the Board, President and Chief Executive Officer*
David J. Fogarty	*Executive Vice President*
John E. Bryson	*Executive Vice President and Chief Financial Officer*
Michael R. Peevey	*Executive Vice President*
P. L. Martin	*Senior Vice President*
L. T. Papay	*Senior Vice President*
Kenneth P. Baskin	*Vice President, Nuclear Engineering, Safety and Licensing*
Glenn J. Bjorklund	*Vice President, Power Supply*
R. H. Bridenbecker	*Vice President, Customer Service*
John R. Bury*	*Vice President and General Counsel*
Richard K. Bushey	*Vice President and Controller*
Robert Dietch	*Vice President, Engineering, Planning and Research*
John R. Fielder	*Vice President, Information Services*
Charles B. McCarthy, Jr.	*Vice President and Site Manager, San Onofre Nuclear Generating Station*
Michael L. Noel	*Vice President and Treasurer*
Harold B. Ray	*Vice President, Fuel and Material Management*
Jennifer Moran	*Secretary of the Corporation*

* Effective March 1, 1989, Mr. Bury has elected to retire and David N. Barry III will become Vice President and General Counsel.

SHAREHOLDER INFORMATION

Stock Listing:

The Cumulative Preferred Stock, 4.08% Series, 4.24% Series, 4.32% Series, 4.78% Series and 5.80% Series, and the $100 Cumulative Preferred Stock, 7.58% Series, 8.54% Series, 8.70% Series and 8.96% Series are listed for trading on the American and Pacific Stock Exchanges. The issued and outstanding common stock of the Company is wholly-owned by SCEcorp and as a result is not listed for trading on any stock exchange.

Stock Transfer Agent:

Southern California Edison Company
Secretary's Department
2244 Walnut Grove Avenue
P. O. Box 400
Rosemead, California 91770
(800) 347-8625

Registrar of Stock:

Through December 31, 1988—

Security Pacific National Bank
Los Angeles, California

Effective January 1, 1989—

Southern California Edison Company
Secretary's Department
2244 Walnut Grove Avenue
P. O. Box 400
Rosemead, California 91770
(800) 347-8625

50-528/529/530 8910190218

-NOTICE- 10/11/89

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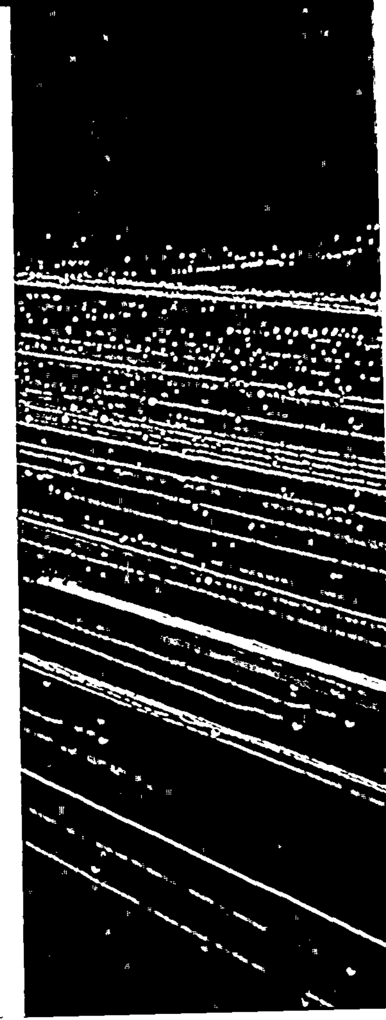
-NOTICE-



COVER: Colorful beams of light illuminate an urban landscape in the San Gabriel Valley, near the corporate headquarters of SCEcorp and its electric utility subsidiary, Southern California Edison Company.

A New Corporate Structure

A historic change for the corporation took place in 1988 with the formation of SCEcorp, the parent holding company of Southern California Edison Company. This new corporate structure, which went into effect on July 1 following shareholder approval, more clearly separates the regulated utility operations of Edison from the operations of SCEcorp's nonutility subsidiaries. With its headquarters in Rosemead, California, SCEcorp is primarily an energy-services company whose subsidiaries have combined assets of $14.9 billion.

SCEcorp's principal subsidiary is Edison, a 102-year-old electric utility that serves 3.8 million customers in Central and Southern California. More than 10 million people live within its 50,000-square-mile service territory—one of the nation's most dynamic and prosperous regional economies.

The nonutility subsidiaries of SCEcorp that operate as The Mission Group are engaged primarily in businesses related to the corporation's expertise in the energy industry. The Mission Group subsidiaries have projects in eight states, including electric power generation, engineering and construction of electric facilities, real estate development, and financial investments.

Under the new corporate structure, SCEcorp will continue a long tradition of providing good service to customers and a competitive return to shareholders.

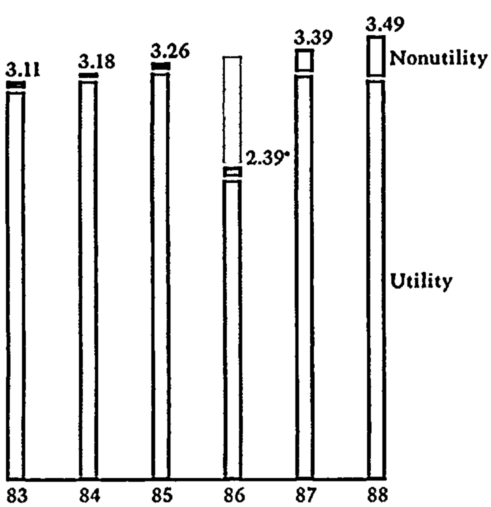
SCEcorp Highlights

	1988	1987	Increase (decrease)	Five-year compound annual growth rate
For the year (000):				
Revenue	$6,252,719	$5,601,926	11.6%	7.0%
Net income	$761,831	$738,531	3.2	4.3
Common stock dividends paid	$530,409	$507,808	4.5	8.4
Weighted-average shares of common stock	218,332	218,014	0.1	1.9
At year-end:				
Assets (000)	$14,866,276	$14,350,664*	3.6	5.2
Liabilities (000)	$8,010,685	$7,798,136	2.7	5.1
Common shareholders' equity (000)	$5,064,848	$4,833,734*	4.8	6.0
Common shareholders	148,427	156,154	(4.9)	(1.3)
Employees	16,995	17,255	(1.5)	0.8
Per share:				
Earnings	$3.49	$3.39	2.9	2.3
Dividends	$2.48	$2.38	4.2	5.5
Book value	$23.18	$22.16*	4.6	4.3
Market price	$32⅜	$30½	6.1	10.3
Financial ratios:				
Rate of return on common equity	15.3%	15.5%*		
Dividend payout	69.6%	68.7%		
Dividend yield	7.7%	7.8%		
Price-earnings	9.3	9.0		
Total shareholder return (price appreciation and dividends)	14.1%	(3.1)%		

**Reflects restatement for nuclear plant disallowance.*

Earnings Per Share (SCEcorp)

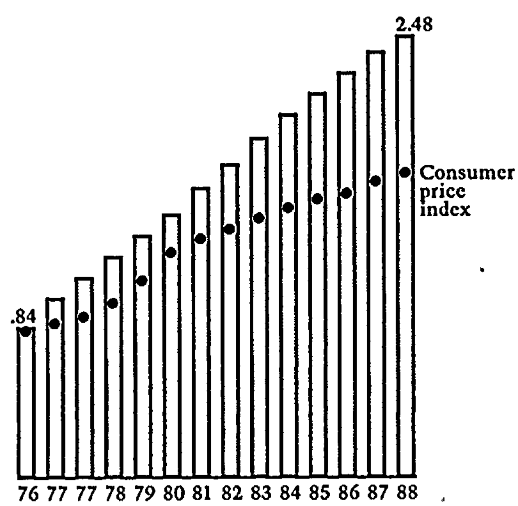
In dollars



**Reflects restatement for nuclear plant disallowance*

Annual Dividend Rate Per Share (SCEcorp)

In dollars



The Year at a Glance

- SCEcorp's earnings per share of common stock increased 2.9% to a record high of $3.49 in 1988.

- The boards of directors of SCEcorp and San Diego Gas & Electric Company (SDG&E) approved an agreement to merge SDG&E into Edison. The company is working to complete the approval process for the proposed merger in early 1990, subject to the approval of shareholders of the companies, the California Public Utilities Commission (CPUC), the Federal Energy Regulatory Commission and other regulatory agencies.

- The board of directors of SCEcorp raised the common-stock annual dividend 4.2% in June to $2.48, the 13th increase in the past 12 years.

- The return to SCEcorp's common shareholders from stock price appreciation and dividends was 14.1% in 1988. The annual return to shareholders has averaged more than 19% for the past 5-year and 10-year periods, exceeding the Dow Jones industrial and utility averages, as well as the S&P 500 index.

- SCEcorp's net income rose to a record $761.8 million and revenue to a record $6.3 billion.

- The Mission Group of nonutility subsidiaries earned net income of $77.8 million, or 35 cents per share, from revenue of $333.1 million; nonutility earnings were 10.0% of SCEcorp's total earnings.

- Southern California Edison, the utility subsidiary, internally generated 100% of the funds needed to meet capital requirements, up from 77% in 1987, and the highest level in more than 30 years.

- The utility's sales to retail customers increased 3.9% to 66 billion kilowatt-hours (kwh); total electric sales, which include sales to municipal and utility customers, rose 3.6% to 68 billion kwh.

- The utility recorded a net gain of 114,394 new customers, the third-largest annual increase in Edison's history.

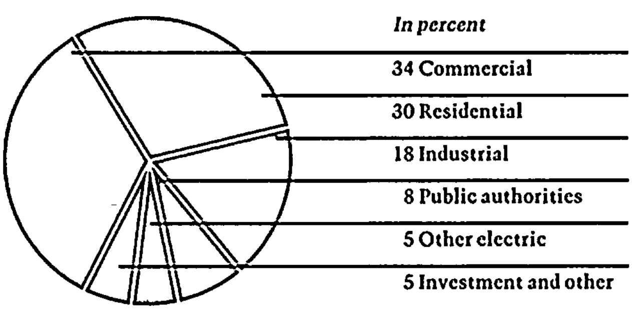
- Edison customers set a record peak demand for electricity of 15,987 megawatts (MW) on September 6, 1988, breaking the previous mark of 15,189 MW set in 1984.

- The CPUC authorized the recovery of $465 million in fuel and purchased-power expenses, $116 million for inflation and capital costs in an attrition allowance and an increase in Edison's authorized return on common equity from 12.75% to 13.0% for 1989. The CPUC also found that $295 million of Edison's added investment in San Onofre Nuclear Generating Station Units 2 and 3, since they began operating commercially, was reasonable.

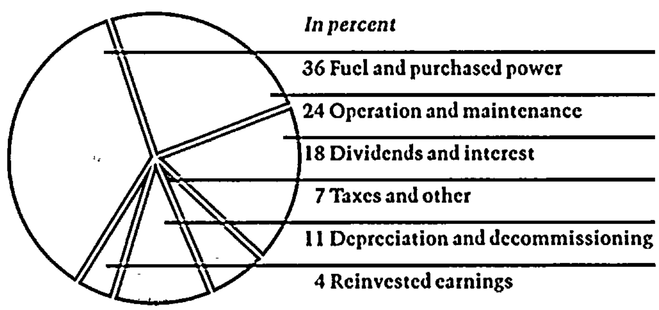
- Edison achieved its cost-containment goals of reducing capital expenditures and limiting growth in operation and maintenance expenses to below the annual rate of inflation.

Sources and Distribution of Revenue (SCEcorp)

Sources



Distribution



Another Outstanding Year

Few years in the 102-year history of our company have matched 1988 for major changes, major challenges, and major achievements. It was a year of notable successes.

1988 saw us achieve record earnings, $3.49 per common share compared with $3.39 in 1987, and our 13th dividend increase in the last 12 years. The return to our common shareholders in 1988 from dividends and stock-price appreciation was 14.1%, and has averaged more than 19% annually for the last 10 years. We added 114,000 new customers to our electric system, the third-largest increase ever in our service territory.

Merger Agreement with SDG&E

In late November, our board of directors and that of San Diego Gas & Electric Company (SDG&E) approved a definitive agreement to merge SDG&E into our electric utility subsidiary, Southern California Edison Company. Under terms of the agreement, each SDG&E common share will be exchanged for 1.3 newly issued SCEcorp common shares. Existing SDG&E preferred issues will be exchanged for newly issued SCEcorp preferred shares. The merger requires approval of shareholders of both companies, as well as regulatory approvals by the California Public Utilities Commission (CPUC), Federal Energy Regulatory Commission (FERC), and other regulatory agencies. We are working to complete the approval process in early 1990.

Our merger proposal has received opposition in the San Diego area, largely based on the issue of loss of a hometown headquarters company. Our position is that lower electric rates, better service, and increased community support are more important to consumers than having a locally headquartered utility with higher electric rates. We plan to demonstrate the substantial customer and community benefits for San Diegans in our regulatory proceedings, and are confident that when the facts are known, our merger will be accepted.

Holding Company

As described on Page 1, SCEcorp came into existence on July 1 as the parent holding company of Southern California Edison, our electric utility subsidiary, and The Mission Group of nonutility businesses.

Cost Containment

Although the San Diego merger was a major focus in 1988, we also made internal changes necessary to ensure that this enterprise will continue to be financially strong, service-oriented and competitive in its operations. We restructured the organization to increase productivity and eliminate duplication and unnecessary expense. We reduced the number of officers, managers, and administrative and field personnel throughout the company, streamlining every department. This reflects much attention, care, and effective hard work by Edison people and keeps us on track to meet our five-year corporate goal to reduce Edison's 1992 revenue requirements by $900 million from a business-as-usual level. Growth of Edison's operating and maintenance expenses for 1988 were under the rate of inflation. Edison reduced employment by 426 positions, or 2.5%, through attrition and retirements, with few layoffs.

Health-care costs have been increasing nationally for major corporations and for our company at about 20% a year. To have a benefits program that would be more responsive to employee needs, and yet help control escalating health-care costs, we implemented a comprehensive new program that enables our employees to match benefits with personal and family needs.

Quality Service

Our Edison companywide quality service programs found literally hundreds of ways to give better and more responsive service to our customers. For example, we expanded surveys to determine customer needs, reduced response times on telephone calls from customers, created a more understandable customer bill, changed electric-circuit switching procedures to reduce outages during maintenance work, and trained employees in better service, work techniques and practices.

Nuclear Operations

By every measure, our San Onofre Nuclear Generating Station had an excellent year. The station achieved record energy output, tight cost control, recognition from federal regulators for safe and professional nuclear operations, and a record 3.8-million work hours without a lost-time injury accident.

Generating Resources, Purchased Power and Fuel

Our nine different energy production resources help protect our customers from unforeseen changes in world energy markets. Our coal, nuclear and oil- and gas-fired plants remain our primary generating resources. Our coal and nuclear plants achieved another year of record production. Increases in the cost of natural gas and reduction in the reliability of its supply are causing us to change our gas supply practices. We are engaged in efforts to obtain more gas from different sources. Our hydro production was down because of the second year of drought conditions. Purchased power in balanced amounts remains an important and cost-effective resource. Alternative and renewable generation resources also remain important, but in many cases are not cost-competitive today.

Customer Self-Generation

Through CPUC actions and our own efforts, we are reducing the threat of large commercial and industrial customers bypassing the Edison system. This has been a major company effort, because if these large customers leave the system, the remaining customers will be required to pay higher rates to cover fixed costs.

Mission Group

Earnings of The Mission Group, our nonutility businesses, contributed 35 cents per share, or 10% of SCEcorp's total earnings, up from 5.6% in 1987, and an increase of 84%. The Mission Group subsidiaries—Mission Energy, Mission Land, Mission Power Engineering, and Mission First Financial—are an important part of our financial strength. They have exceeded our expectations and are expected to grow in the future.

Management

We have fewer officers than any other major electric utility enterprise. Your company's top management team consists of Executive Vice Presidents David J. Fogarty, John E. Bryson, Michael R. Peevey and myself, with ages ranging from 45 to 63, and disciplines of engineering, law and economics. Cross-training is an important part of our management strategy. Edison Senior Vice President Larry T. Papay moved from Power Supply to a new position overseeing Nuclear Operations. Edison Vice President Glenn J. Bjorklund moved from System Planning and Research to Power Supply, and Edison Vice President Robert Dietch took on Mr. Bjorklund's former responsibilities in addition to his position as vice president of Engineering and Construction.

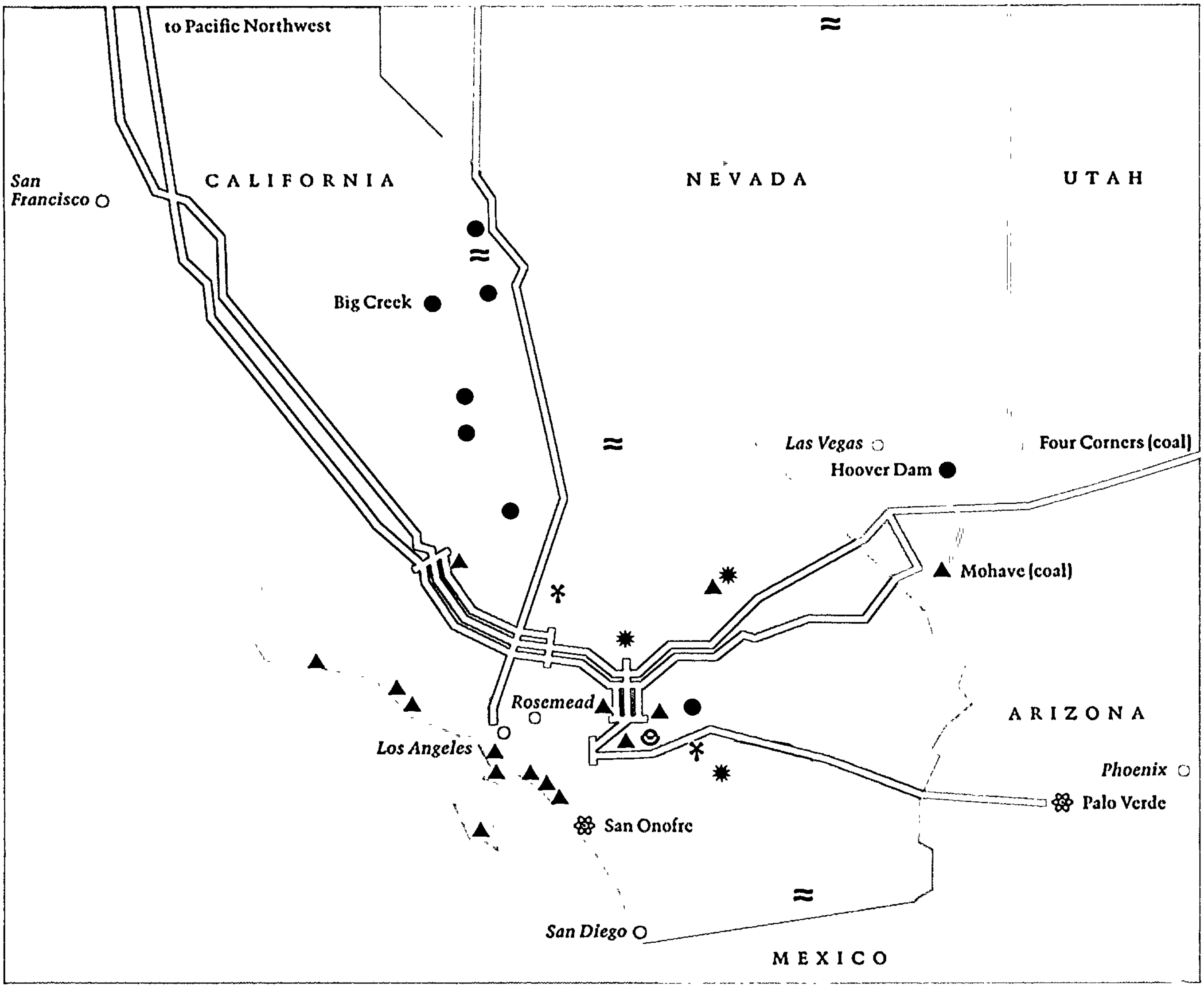
In December, the board of directors elected two new officers. Effective January 1, 1989, John R. Fielder became Vice President–Information Services of Southern California Edison. Effective March 1, 1989, David N. Barry III becomes Vice President and General Counsel of SCEcorp and Southern California Edison, succeeding John R. Bury, who retires after 35 years of dedicated service.

At our annual meeting in April we will mark the retirement from our board of directors of Jack K. Horton, who provided our company with wise leadership and counsel as President beginning in 1959, as Chairman beginning in 1968, and as Chairman of the Executive Committee since 1980. He has been a friend and an inspiration to all of us, and we will miss him.

1988 was a good year for our company. Much still has to be done. With the wise counsel and policy direction of our board of directors, the leadership of an extraordinarily able team of officers and managers, and the outstanding efforts of all our employees, we will meet 1989's challenges. On behalf of shareholders, I thank our people for their dedication and hard work in 1988. I look forward to leading them again this year.

Howard P. Allen
Chairman, President and
Chief Executive Officer

February 21, 1989



□ Southern California Edison Company service territory

〓 Extra-high-voltage transmission lines

● Hydroelectric

▲ Fossil

❁ Nuclear

≈ Geothermal

✲ Wind

✹ Solar

⊖ Biomass

Operations Review: Southern California Edison Company

Southern California Edison Company, the utility subsidiary of SCEcorp, provided more electricity to more customers during 1988 than ever before in its 102-year history. The company also strengthened its commitment to quality service while rigorously controlling costs. Its success in serving customers and providing shareholders with a competitive return reflected the effective hard work and dedication of its 16,660 employees.

Growth in Service Territory

Edison serves more than 3.8 million customers in a 50,000-square-mile service territory that covers much of Central and Southern California. With headquarters in Rosemead, California, Edison is a regulated, investor-owned utility providing electric service to one of the nation's most robust and prosperous regional economies.

The company had a net gain of 114,394 new customers in 1988, the third-highest increase in its history. Residential customers represented about 87% of the total growth. In the next five years, Edison projects growth of approximately 450,000 customers.

The increase in customers was the primary reason for a 3.9% rise in retail electric sales—to 66.0 billion kilowatt-hours (kwh) from 63.5 billion kwh in 1987. Edison's total electric sales in 1988, including sales to other utilities and municipalities, rose 3.6%—to 67.9 billion kwh from 65.5 billion kwh in 1987.

During an extended heat wave, customers' demand for electricity rose to a record peak of 15,987 megawatts (MW) on September 6, breaking the previous mark of 15,189 MW set in 1984. The primary reason for this record was the heavy use of air conditioning, as residential customers sought relief from the fourth consecutive day of 100-degree-plus temperatures.

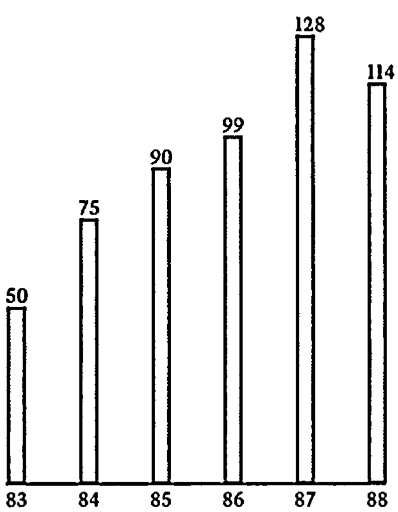
Focus on Large Customers

For several years, the company has faced the possibility that some large commercial and industrial customers would leave its system and generate their own electricity. This problem essentially results from earlier state and federal regulatory and legislative decisions that had distorted electricity pricing since the late 1970s. But with support from the California Public Utilities Commission (CPUC), Edison has made substantial strides in 1988 toward stemming the potential loss of these large customers.

The electricity price structure, which the current CPUC is reforming, has subsidized residential customers at the expense of many commercial and industrial customers. Consequently, many large customers have paid significantly more than what it costs Edison to serve them, and in some cases more than it would cost them to generate their own electricity. If these large customers leave the Edison system, the result would be fixed costs spread over a smaller customer base,

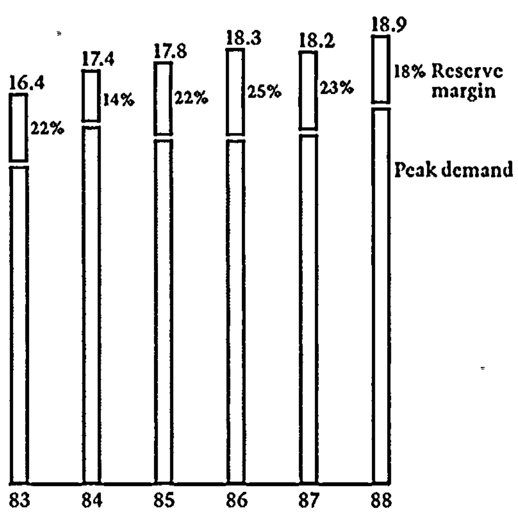
New Customers (Utility)

In thousands



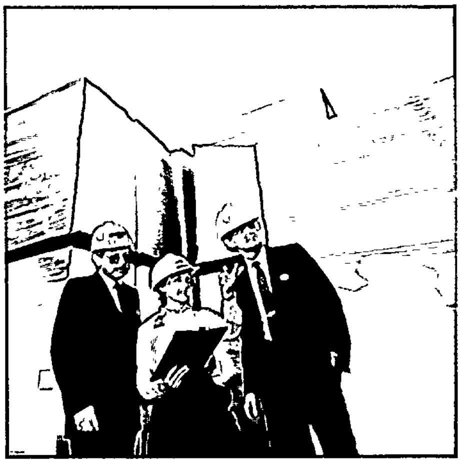
Peak Demand and Reserve Margin (Utility)

In thousands of megawatts



Focus:

Specialized Service for Large Customers

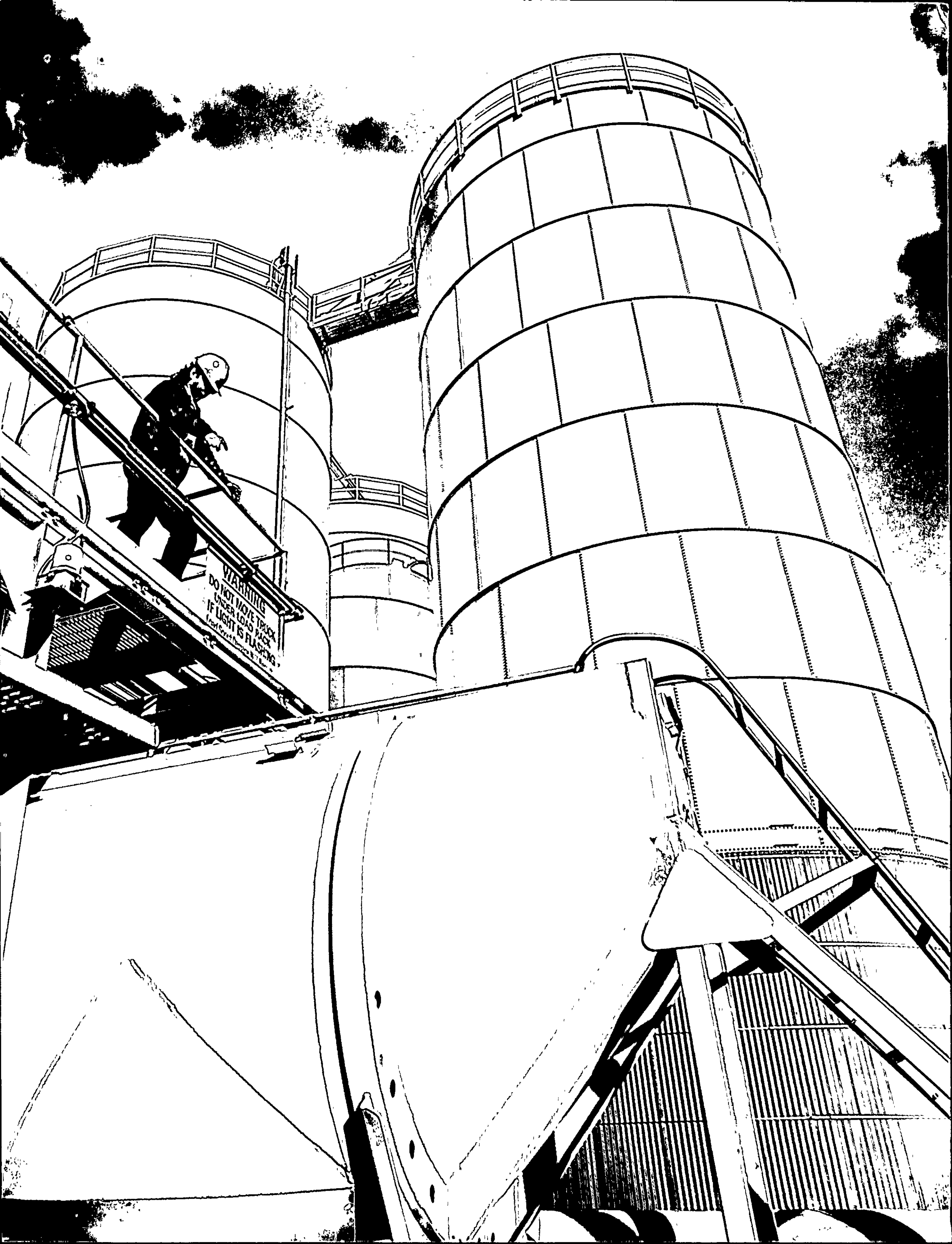


This major industrial customer deferred installation of a 3.1-megawatt generating unit at its plastics manufacturing facility in Torrance, California. The customer qualified for a lower electric rate, negotiated by Edison and approved by the California Public Utilities Commission (CPUC). As a result, the utility will continue serving this large industrial customer that otherwise would have left the utility's electric system.

In addition, Edison has sought lower electric bills for industrial and commercial customers by changing an overall rate structure that has subsidized residential customers since the 1970s. A new rate structure for all customers, approved by the CPUC, went into effect on January 1, 1988, following Edison's request to bring rates more in line with its actual costs of service to different classes of customers.

Furthermore, the company provides a variety of energy-related services to its 200 largest customers. Highly trained account representatives serve as a single point of contact in promptly meeting all of their energy needs and advising them on ways to cut costs. ◻

A major industrial customer *(right)* took advantage of Edison's lower rates and specialized services at its plastics operations in Torrance. Two Edison employees *(above)* advise a representative of the company.


WARNING
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increasing electricity prices to remaining customers—particularly residential customers.

A number of actions taken by Edison and the CPUC have helped correct this problem. In response to Edison's request in its 1988 general rate case, the CPUC has begun to establish cost-based rates that more closely reflect the actual costs of serving each customer class. On January 1, 1988, the commission increased residential rates an average of 4.9% and decreased rates for large commercial and industrial customers an average of 4.7%. The CPUC also has given Edison more flexibility in negotiating special rates and services for large customers who are planning to generate their own electricity.

Edison's 200 largest customers represent 20% of its revenues. Because of their importance, the company has established a highly trained group of professionals who serve as single points of contact for each of these large customers.

As a result of these efforts, large commercial and industrial customers in 1988 deferred or cancelled more than 200 proposed generating projects, representing 325 MW. If these self-generation projects had been built, Edison's sales would have fallen about 2.4 billion kwh, the equivalent of approximately $185 million in annual revenue, and rates for the remaining customers would have increased.

This is an example of how past public policy decisions, which were made with good intentions, can be harmful to the public interest if not reviewed and revised on a timely basis.

Emphasis on Cost Control and Productivity

In 1988, the company continued its major effort to reduce costs and increase productivity without sacrificing high-quality service to customers. These strong cost-containment efforts are necessary to ensure that Edison remains financially strong and competitive in today's business environment.

Under its five-year cost-containment plan begun in 1987, the company is committed to reduce by $900 million its projected revenue requirements from customers by 1992. Edison achieved its cost-containment goals in 1988 by reducing planned-construction expenses, lowering inventory requirements, and tightly controlling increases in operations and maintenance expenditures below the annual rate of inflation.

A good example of Edison's efforts to reduce and control costs was the complete revision of its health care program. These costs, like those of other major corporations nationwide, have been rising at more than 20% annually since 1980. In response, Edison developed an innovative and comprehensive flexible-benefits program, called SCEflex, which gives employees the ability to choose the benefits that best suit their personal and family needs. At the same time, it allows Edison and employees to better control benefits and health-care costs. In general, the savings result from more favorable rates negotiated with doctors and hospitals, a new system of managed care that reduces the number of unnecessary medical procedures and a totally new benefits and health-care plan. In all, SCEflex will continue to provide Edison employees with one of the best benefit and health-care programs in the nation, while also achieving substantial savings and cost control in this high-cost area.

In another major effort to streamline operations and control costs during the year, Edison began consolidating its telephone and customer-accounting centers from four locations to two. This was possible because of the interconnection of the telephone centers, which handle more than 6 million calls annually. As a result, all Edison representatives can now answer calls from customers residing anywhere in the 50,000-square-mile service territory. The consolidation will result in more efficient use of personnel, as well as save about $7 million in capital expenditures and $1.3 million annually in operating costs. To achieve this consolidation, Edison made a special effort to minimize hardship on employees by offering them similar positions at the two remaining centers and by providing other job opportunities.

In 1988, the company continued to restructure and streamline a number of departments, and to increase the efficiency of its work force. Total employment for Edison at year-end dropped 426 to 16,660. According to the most recently available data on the ratio of customers to employees, Edison ranks first among the nation's 15 largest electric utilities in productivity.

Commitment to Quality Service

Quality service has been the foundation of Edison's management philosophy throughout its history—but never more so than today. Since its early days, the company's motto has been, "Good Service, Square Dealing, Courteous Treatment." During 1988, Edison employees again demonstrated this commitment—both at field locations and in offices throughout the service territory.

When severe wind and rainstorms struck in January, February, and December, Edison emergency crews and other personnel mobilized quickly and worked around the clock to restore service to more than 1¾ million affected customers. During the extended heat wave in early September, when temperatures soared to 110 degrees and demand for electricity reached new records, more than 1,300 employees worked an additional 52,000 hours to replace damaged transformers and make other repairs, and restore electric service.

Employees in departments throughout Edison also developed innovative programs to improve customer service. As an example, quality-service teams in many departments helped coordinate procedures to ensure more rapid and efficient responses to customers. To measure the level of customer satisfaction, and respond better to their needs, Edison actively sought more feedback from customers through surveys and interviews. The company also expanded programs that recognize and reward managers and employees whose suggestions increase productivity, lower costs, or provide better service.

Among other important steps taken to enhance quality service in 1988 were:

- Introduction of a new customer bill that presents more information in a simpler, clearer way;
- Installation of a new telecommunications circuit-switching system between voice and data networks, which has increased employee productivity, reduced costs and improved customer service;
- Support for the sixth consecutive year in paying the winter electric bills of 8,800 low-income, elderly and disabled customers through Edison's Winter Energy Assistance Fund and generous voluntary contributions from customers;
- Notifying customers of a 24-hour telephone service to respond to their requests, such as starting or stopping service, answering questions on billing and reporting electric outages;
- Assistance to nearly 46,000 low-income and needy customers by providing various energy-management services, including bilingual help and free installation of energy-efficient equipment;
- Implementation of a good-neighbor program under which customer-contact personnel refer elderly customers who need assistance—such as medical care, meals and transportation—to various community agencies;
- Introduction of a toll-free telephone number for shareholders, which has provided faster and more convenient service; and
- Expansion of service to a rapidly growing number of non English-speaking customers through community programs, as well as toll-free telephone service by Edison representatives who are fluent in Spanish, Chinese, Vietnamese and Cambodian.

Diversity in Generating Resources

The company historically has sought diverse generating resources to provide customers with reliable electric service at reasonable cost. Using nine different resources, more than any other utility in the world, Edison has great flexibility in adjusting to unforeseen changes in world energy markets.

Nuclear Plants Edison's nuclear power plants in Southern California and Arizona had another excellent year, generating more than 21% of customers' electricity needs, up from 20% in 1987. The output reflects the strong operating performance of the San Onofre Nuclear Generating Station and the first full year of operation for all three units at the Palo Verde Nuclear Generating Station in Arizona.

Edison's three nuclear units at the San Onofre plant generated more than 16% of the electricity needed to serve Edison customers in 1988. Their output saved customers the cost of about 21 million barrels of oil or the equivalent in natural gas, resulting in fuel savings of about $275 million. Edison manages and operates the three San Onofre units, owning 80% of the 450-MW Unit 1 and 75% of Units 2 and 3, which have a combined capacity of 2,200 MW.

On average, the three units at San Onofre produced 74% of their capacity for the year, exceeding the national average for nuclear plants. Unit 1, which commenced commercial operation in 1968, was out of service for more than six months in 1988 for refueling and completion of electrical modifications required by the federal Nuclear Regulatory Commission (NRC). Unit 2 operated at 95% of its capacity for the year, and was the third-highest producer of electricity among the nation's 109 nuclear units. Unit 3 operated at 66% of capacity, and completed its third refueling during 1988.

In 1988, the lifetime generation of San Onofre plant exceeded 100 billion kwh of electric generation, saving customers the cost of more than 160 million barrels of oil or the equivalent in natural gas.

Edison has been given high marks for the safe and professional operation of the San Onofre units by the NRC and the Institute of Nuclear Power Operations.

Focus:

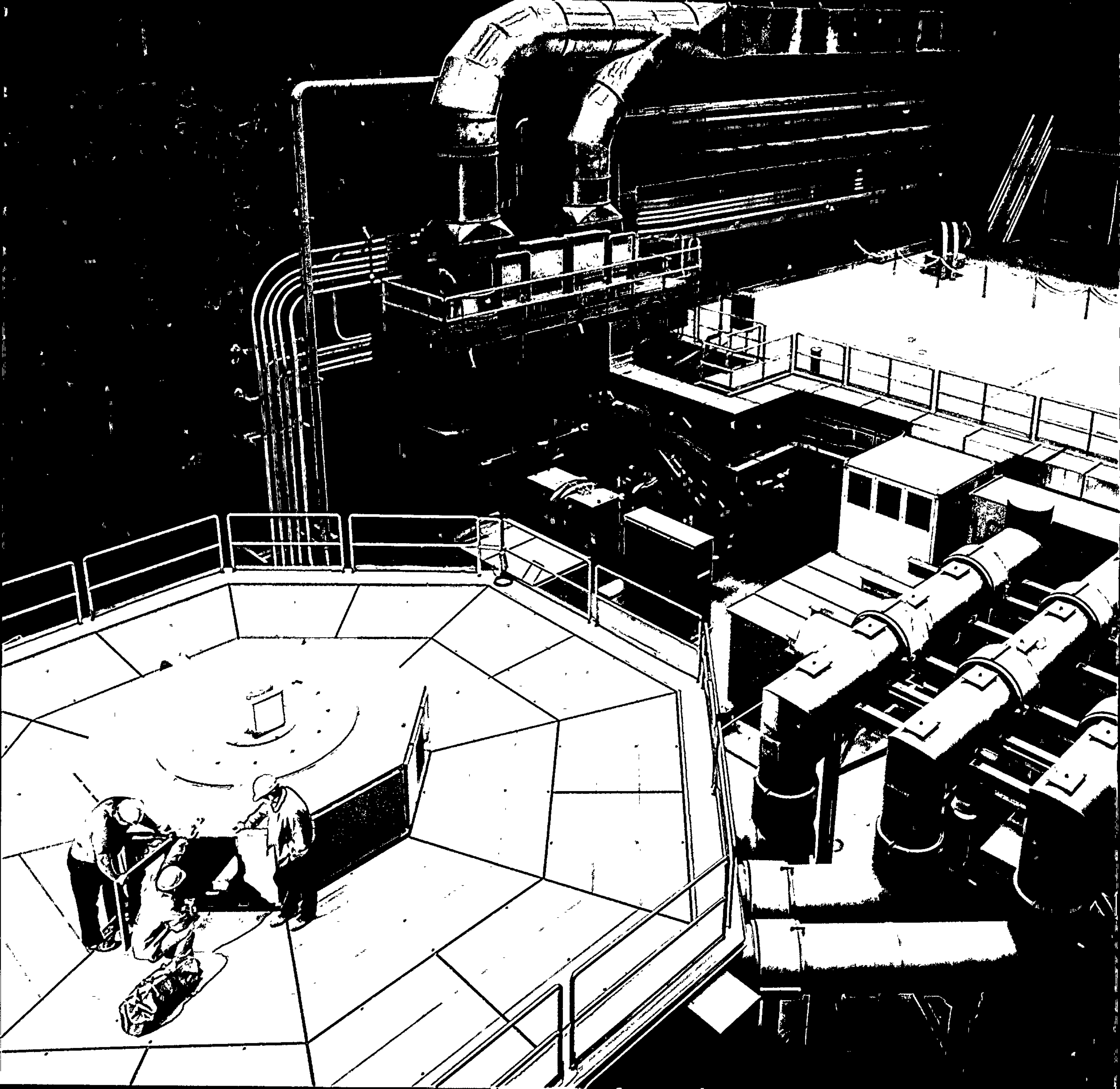
Expansion of Hydroelectric Resources

Edison dedicated the Balsam Meadow hydroelectric facility in June, making it the newest and largest addition to the Big Creek system in the Sierra Nevada. The company designed and managed the $277 million project, which was built by blasting four miles of tunnels through solid granite to connect Huntington and Shaver Lakes. The 207-megawatt power station is 1,000 feet below ground in a huge excavated cavern and was named in honor of John S. Eastwood, the visionary engineer who originally conceived the Big Creek hydroelectric system in the late 1800s.

Edison commemorated Big Creek's 75 years of continuous operation in October. This immense hydroelectric complex now consists of six major lakes, 16 tunnels extending a total of 48 miles, and nine powerhouses with 24 generating units. Big Creek is an important source of reliable, low-cost power for Edison, representing 1,000 megawatts of capacity, or enough power to serve 500,000 people.

By using computers and fiber optics communications, Edison was able to reduce costs and increase efficiency in operating all of Big Creek's generating units from a single control center. □

Maintenance workers *(right)* inspect generator at the John S. Eastwood powerhouse of the Balsam Meadow hydro facility, built 1,000 feet underground in the Sierra Nevada. Two employees *(above)* measure the depth of the forebay above the hydro facility.



The company also owns a 15.8% interest in the Palo Verde Nuclear Generating Station near Phoenix, Arizona, whose three 1,221-MW units comprise the largest nuclear plant in the country. These units, managed by Arizona Public Service Company, went into commercial operation on February 1, 1986, September 19, 1986, and January 20, 1988, respectively.

Total generation from the three Palo Verde units was the highest among all nuclear plants in the United States. In addition, Unit 3 had the highest production nationwide for an individual nuclear unit. Palo Verde Units 1, 2 and 3 operated at capacity factors of 62%, 63% and 95%, respectively. Both Units 1 and 2 completed their first refueling outages in 1988; Unit 3 will have its first refueling in 1989.

Fossil-Fuel Power Plants The company's 54 oil and natural gas units, with 10,000 MW of capacity, provided 26% of customers' electric needs in 1988. The two coal-fired plants located outside California produced an additional 15%. Edison operates and owns 56% of the Mohave Generating Station in Nevada and owns 48% of the Four Corners Generating Station's Units 4 and 5 in New Mexico. The Mohave plant operated at 73% of its maximum capacity and Four Corners at 80%—new production records for both plants. Edison was awarded $7.9 million in 1988 under the CPUC's coal-plant incentive program. Though the CPUC suspended this program in July, it requested Edison to develop and recommend an alternative incentive plan in 1989.

Hydroelectric Plants Low precipitation in 1987 and 1988 limited the company's hydroelectric generation to 4% of customers' electricity needs in 1988. The Big Creek hydro system in California's Sierra Nevada is the primary source of this low-cost power, representing 1,000 MW of capacity. Begun in 1911, this extensive hydro system now consists of six lakes, 12 major dams, nine major tunnels and nine powerhouses. In June, the company dedicated the 207-MW Balsam Meadow hydro project, the largest and most recent addition to the Big Creek system.

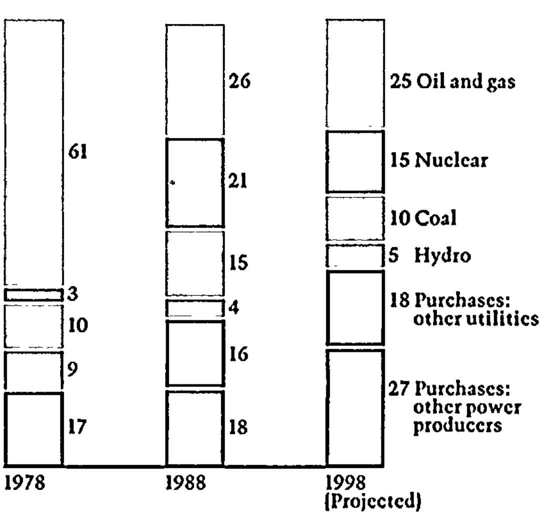
In addition, Edison has an allotment of 277 MW of hydroelectric capacity from the Hoover Dam on the Colorado River.

Purchased Power The purchase of power from a diversity of outside sources gives Edison added flexibility in meeting its customers' electric needs. Edison's total electricity purchases met 34% of customers' needs during the year, compared with 24% in 1987. This growth resulted primarily from a large increase in purchases from nonutility power producers in California.

Economy-Energy Purchases: The company made short-term "spot-market" purchases of low-cost electricity from the Pacific Northwest and Southwest, which saved customers nearly $100 million in 1988, compared with the cost of generation using natural gas. Economy-energy purchases supplied about 9% of

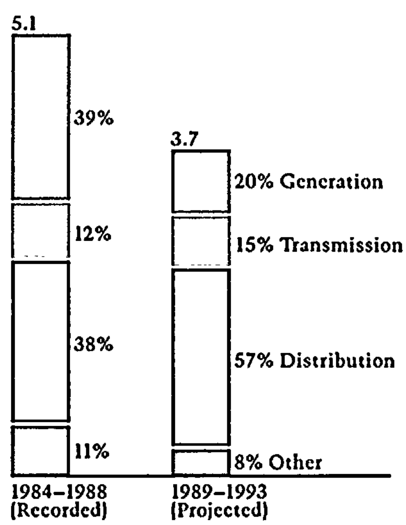
Generation Mix (Utility)

In percent



Construction Expenditures (Utility)

In billions of dollars



customers' total electric needs in 1988 and had an average cost of 1.8 cents per kwh, compared with 1.6 cents in 1987.

During 1988, Edison purchased and exchanged power as an active member of the Western Systems Power Pool (WSPP), the largest power pool in the nation. The company played a major role in establishing WSPP in 1987 as a two-year experiment by 24 public- and investor-owned utilities in 10 Western states. Pool members use a centralized computer to efficiently buy and sell low-cost surplus power, and make better use of existing generation and transmission facilities. Market forces, rather than regulatory agencies, determine power prices under this program. To date, results of the experiment have been favorable, and efforts are under way to have the Federal Energy Regulatory Commission (FERC) extend it another two years.

Firm-Energy Purchases: Purchases under long-term contracts with other utilities supplied 7% of customers' electricity needs at an average cost of 4.1 cents per kwh.

In June, after several years of negotiating, Edison reached agreement on a 20-year sales-and-exchange contract with the Bonneville Power Administration (BPA). The contract provides the company with 250 MW of capacity and 1.2 billion kwh annually beginning July 1, 1989. The agreement also will provide Edison with an additional 250 MW during times of unexpectedly high electric demand. The contract, approved by the FERC and CPUC, will save Edison customers an estimated $30 million or more annually, compared with the least-cost alternative of refurbishing some of Edison's existing oil and gas generating units now on standby status.

Purchases from Nonutility Power Producers: Alternative and renewable energy projects, developed by nonutility power producers, supplied about 18% of customers' needs during 1988—nearly a 90% increase over 1987.

In 1978, the federal Public Utility Regulatory Policies Act (PURPA) was enacted to encourage the development of alternative and renewable energy sources by requiring electric utilities to purchase power from qualifying nonutility producers. Each state was required to establish its own implementation rules. In California, CPUC policy at that time required Edison and other utilities to buy power from qualifying facilities under long-term contracts. Generally, this power was not needed to meet customer demand, and was much more costly than power Edison can now produce or purchase from other utilities.

In 1988, electricity purchased from qualifying facilities cost an average of 6.3 cents per kwh, higher than Edison's average costs for both economy- and firm-power purchases from other utilities. The higher costs for power supplied by qualifying facilities cost Edison's customers an estimated $200 million in 1988 and will cost an estimated $260 million in 1989. This is another example of well-meaning public policy that turned out to be wrong because it was not reviewed and modified on a timely basis.

At the end of 1988, there were 344 nonutility power projects, with a combined generating capacity of 2,446 MW, providing power to Edison under these contracts. Edison also has signed contracts, under CPUC orders, for an additional 133 projects representing another potential 1,884 MW of capacity. Edison estimates that less than half of the electric capacity of these remaining projects will go into service, primarily because of changes in federal tax laws, air-quality considerations, and siting and permit requirements.

Major Power Sale: In August, Edison also reached agreement on a 10-year contract to sell between 300 MW and 700 MW of its excess generating capacity to the Sacramento Municipal Utility District, beginning in January 1990. The company estimates that the proceeds from this sale will earn Edison customers between $35 million and $70 million annually, depending on the amount of electricity needed by the Sacramento utility.

Higher Fuel and Purchased-Power Costs

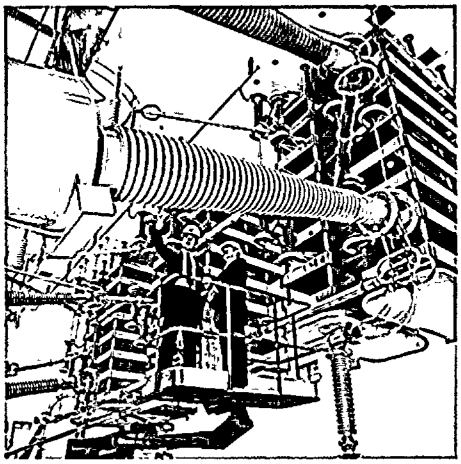
Fuel and purchased-power costs represent Edison's largest expense in supplying electricity to customers. Under California regulation, Edison is allowed to recover these costs from ratepayers on a dollar-for-dollar basis so long as they are reasonably incurred. The costs are subject to periodic reasonableness reviews by the CPUC.

These combined costs rose from $1.87 billion in 1987 to $2.21 billion in 1988. The increase resulted primarily from substantial increases in purchases from nonutility power producers.

Natural gas was the primary fuel used in Edison's gas and oil generating units, except for periods of partial natural gas curtailment in January and August, and later in the year when Edison switched to oil because oil prices declined below gas prices. For the first time

Focus:

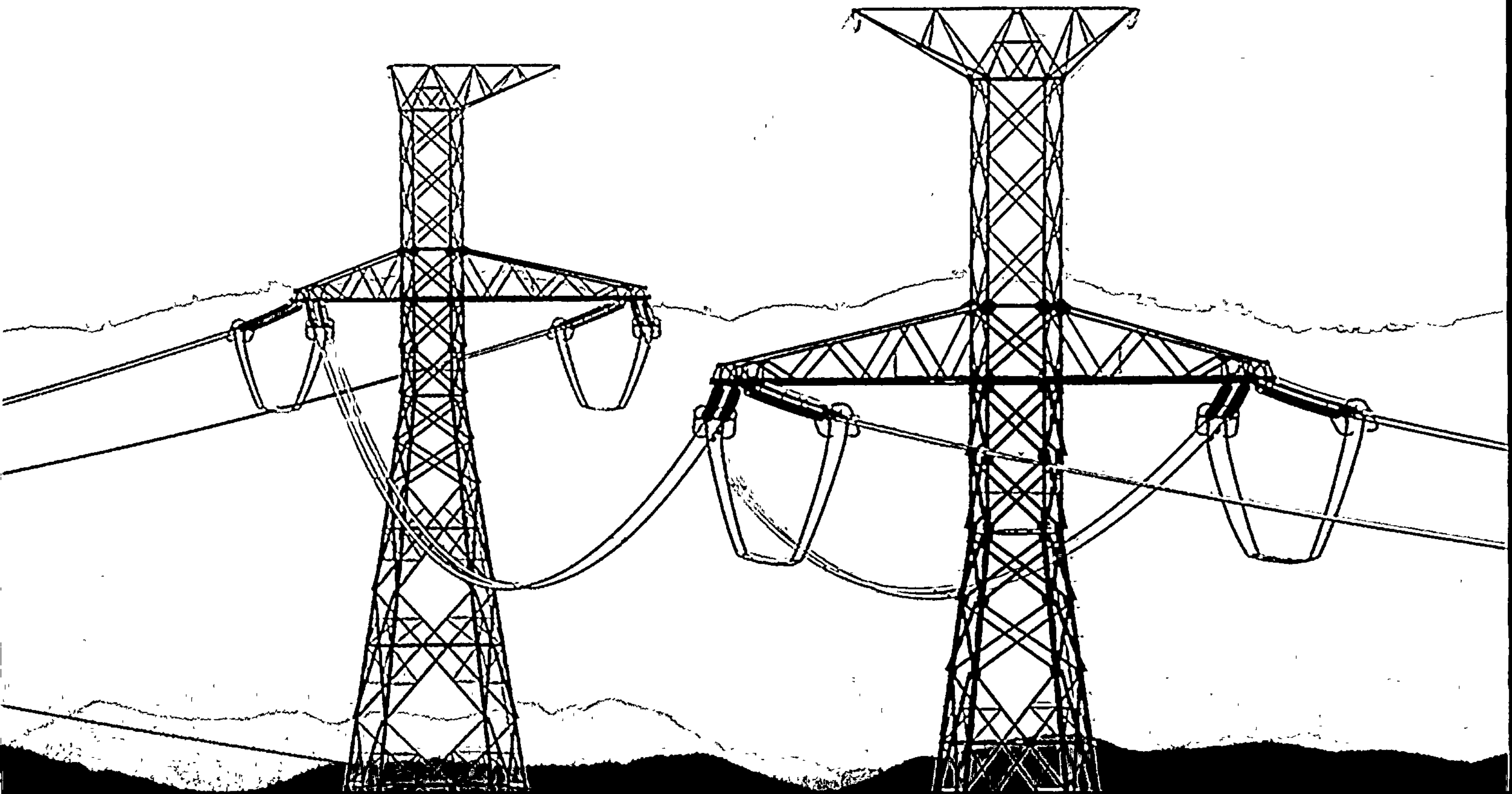
Transmission Capacity Increases to Northwest



Edison will obtain greater access to low-cost power from the Pacific Northwest after completion of a joint project in March 1989 to expand the 850-mile direct-current (DC) line of the Pacific Intertie transmission system. The installation of new equipment converting DC into alternating current (AC) will result in 1,100 megawatts of additional capacity to serve Southern California consumers. The DC line is jointly owned by Edison, the Los Angeles Department of Water and Power, and the municipal utilities of Glendale, Pasadena and Burbank. Completion of the $171-million expansion project will boost Edison's transmission capacity over this line from 421 MW to 643 MW.

The Pacific Intertie is the major link for exchanging power between California and the Pacific Northwest. Built in the 1960s, it includes two AC lines and one DC line, all capable of transmitting large amounts of electricity in either direction at extra-high voltages. A proposal to build a third AC line, known as the California-Oregon Transmission Project, would add 1,600 MW of transmission capacity by 1992, including Edison's 281-MW share. If this third AC line is approved, Edison's total share of transmission capacity from these lines to the Pacific Northwest will rise to 1,900 MW. □

More efficient equipment *(above)* installed at a facility in Sylmar, California, converts DC power used in transmission to AC that customers use. The DC line *(right)* of the Pacific Intertie transmission system supplies customers with low-cost power from the Pacific Northwest.



since the gas shortages of the 1970s, the company's traditional supplier of natural gas restricted its normal gas supplies during the summer, forcing Edison to use more expensive fuels.

In 1988, coal and nuclear fuel prices remained steady, while Edison paid slightly more for oil. However, the average cost of natural gas increased significantly—from an average price of $2.55 per million Btu in 1987 to $3.25 in 1988—primarily because fixed charges from the company's primary supplier remained unchanged despite a lower volume of purchases. To protect its customers, Edison is seeking to develop alternate sources of natural gas from other than its traditional supplier to increase reliability of its gas supply and reduce costs.

Better Service Through Resource Planning and Research

The company's resource-planning strategy gives it maximum flexibility to respond to rapid changes in supply and demand. In the next decade, Edison will add new transmission capacity to gain access to low-cost power, and serve customer needs without construction of major new power plants. To minimize costs, the emphasis will be on greater purchases of electricity, better energy management, and refurbishing and bringing back into service oil and gas plants now on standby status.

In addition, Edison's research programs focus on giving customers more choice, lower cost and better service. For example, Edison is testing a two-way electronic metering and communications network that links the utility with residential customers. This network provides customers with informational services and new options for reducing electricity costs by allowing them to shift their usage to low-cost times. These all-electronic devices also are expected to reduce costs by allowing remote meter-reading—as well as connecting and disconnecting electric service from Edison offices—rather than sending an employee to the customer's location.

In cooperation with other utilities and governmental agencies, Edison also is promoting the development of pollution-free electric vehicles and new advances in battery technology. Increased use of electric vehicles in Southern California would reduce air pollution, traffic noise and gasoline consumption. In addition, nighttime battery charging would increase off-peak electric load, resulting in more efficient use of Edison's generating capacity.

In July, the company began a two-year test program of energy-storage technology at a 10-MW project in Chino, California. The $13.5-million facility is the world's largest battery-energy storage system and charges batteries at night when electricity demand is low and power is less expensive. The facility then supplies electricity during the day when costs and electricity use are much higher. After the completion of this research and development program, Edison will determine the commercial feasibility of this technology.

After successfully completing a six-year test program, Edison in September discontinued operations at Solar One, the world's largest central-receiver power plant using 1,818 sun-tracking mirrors on 130 acres near Daggett, California. A pioneering project in the nation's alternate and renewable energy efforts, the 10-MW Solar One demonstrated the technical capabilities of electrical power production from reflected sunlight. However, the plant is not cost-competitive because lower-cost alternative generation is available.

The 100-MW Cool Water Coal Gasification Plant is on a standby status after completion of its five-year demonstration program. Located near Daggett, California, the plant converts coal into a clean synthetic gas used in turbines to generate electricity. Cool Water is the world's cleanest coal plant and has received numerous awards for its environmental and technological successes. It operated at 70% of capacity in 1988, but is not commercially competitive because more cost-effective alternatives are available.

Although many of these renewable and alternative resources are not cost-competitive today, they will remain important components of Edison's diverse energy-resource mix, especially if oil and gas become scarce or costly in the future.

Emphasis on Employee Development

New and revised employee training programs continued to help employees improve their performance, while enhancing existing skills and the dedication to customer service Edison employees have always exhibited. This increase in professional work skills helped make 1988 a successful year. In 1988, about 4,400 employees participated in various training programs.

Providing a safe and healthful work environment continues to be a high priority at Edison. During 1988, industrial accidents declined 7% from 1987 while lost workdays decreased 15%. The Edison Electric Institute presented 13 safety achievement awards to Edison organizations whose employees worked 1 million or more hours without a lost-time accident.

Affirmative Action The minority representation in the work force rose from 27.4% in 1983 to 31.7% in 1988, while the proportion of female employees increased from 22.9% to 25.2%. Even with this progress, the company seeks to improve its record of insuring greater upward mobility for these employees in management positions.

In 1979, the company established a Women and Minority Business Development Program. From then until the end of 1988, the number of women- and minority-owned enterprises qualified to do business with Edison grew from 207 to 1,548. Annual payments to these firms rose from $18.7 million in 1983 to $92 million in 1988. The company and CPUC have agreed to a new goal of awarding 20% of Edison's annual purchases under competitive conditions to women- and minority-owned businesses within five years.

In addition, Edison reached agreement with four minority-owned businesses in 1988 to manage $35 million of the employee pension fund. With earlier agreements, this increased Edison's total pension investments managed by women- and minority-owned firms to $135 million, or 10% of the fund.

A Commitment to Community Service

Both the company and its employees have a long tradition of participating in community and civic organizations in areas served by Edison in Central and Southern California. For years, employees have voluntarily participated in such activities as the Special Olympics, the Junior Chamber of Commerce, Junior Achievement, YMCA, YWCA and scouting.

Employees showed their spirit of generosity during the 1988 United Way campaign by giving nearly $2.3 million to help people in need. On a per-capita basis, Edison employees were among the leading contributors to the more than 900 charitable organizations supported by United Way.

The Edison Electric Institute honored Edison with its Common Goals Award in 1988, citing excellent contributions made by the company's educational advisory council. This council oversees the company's informational and educational programs to schools.

During 1988, Edison developed educational materials through various school programs in cooperation with teachers, administrators and community leaders. Students learn about energy conservation, electric safety, disaster preparedness, environmental issues and other energy-related topics.

Edison also provides scholarships and grants to students throughout its service territory. For example, the company provides four $12,000 scholarships, 20 career-development awards of $3,000, and 50 educational grants of $500, in addition to two $12,000 scholarship awards for children of employees. Another important educational program, known as the Science Connection, uses a 40-foot mobile classroom to stimulate greater interest in science and technology among elementary school children. Throughout Edison's service territory, this program provided scientific demonstrations to more than 10,000 youngsters during the year. In recognition of this valuable program, the California Department of Education gave the company a special award for its support of science education.

Percentage of male, female, and minority employees at year-end 1983 and 1988	Male % Year-end 1983	Male % Year-end 1988	Female % Year-end 1983	Female % Year-end 1988	Black % Year-end 1983	Black % Year-end 1988	Asian American % Year-end 1983	Asian American % Year-end 1988	American Indian % Year-end 1983	American Indian % Year-end 1988	Hispanic % Year-end 1983	Hispanic % Year-end 1988	Total Minorities % Year-end 1983	Total Minorities % Year-end 1988
Management(1)	83.5	79.3	16.5	20.7	3.7	4.2	5.9	7.6	0.5	0.4	7.5	9.8	17.6	22.0
Administrative & operative(2)	73.7	72.2	26.3	27.8	9.5	9.6	3.3	4.3	1.1	1.4	18.7	21.9	32.6	37.2
Total Edison(3)	77.1	74.8	22.9	25.2	7.5	7.6	4.2	5.5	0.9	1.0	14.8	17.6	27.4	31.7

(1) Includes the "officials" and "professionals" affirmative-action categories.

(2) Includes the "technicians," "office and clerical," "craftsmen," "operators," "laborers" and "service workers" categories.

(3) Includes all classes of employees.

Regulatory Review

1989 Attrition Allowance The CPUC authorized a $116.4-million annual attrition increase in Edison's base-rate revenues effective January 1, 1989. Attrition allowances cover annual changes in costs caused by inflation, capital additions and financings between general rate case proceedings, which are held at three-year intervals. As part of the attrition allowance, the CPUC authorized an increased rate of return on common equity from 12.75% in 1988 to 13.0% in 1989.

San Onofre Units 2 and 3 Costs since Commercial Operation The CPUC authorized an annual revenue increase of $39 million, effective January 1, 1989, as part of its decision allowing Edison to begin recovering $295 million, or 97% of its investment costs incurred at San Onofre Units 2 and 3 after the units began commercial operation. The decision affirmed an agreement between Edison and the CPUC's Division of Ratepayer Advocates (DRA), which was negotiated to avoid a lengthy, expensive review of these costs.

Allegations of Purchased-Power Overpayments The DRA has recommended that the CPUC disallow $124 million of energy costs incurred between late 1984 and late 1987. Approximately $120 million of the proposed disallowance represents alleged overpayments to nonutility power producers, including electricity purchased by Edison from a 300-MW cogeneration facility owned by Kern River Cogeneration Company (KRCC). Mission Energy Company, which is one of SCEcorp's nonutility subsidiaries, is a partner in the KRCC facility. The DRA's proposed disallowance in relation to power purchases from KRCC is approximately $37 million.

In upcoming CPUC hearings, Edison will demonstrate that the power purchases from KRCC actually saved its customers more than $24 million during the three years under consideration, compared with the "standard offer" contract approved by the CPUC.

The DRA also alleges overpayments by Edison under 17 other contracts Edison negotiated with nonutility power producers that are not SCEcorp affiliates. Edison signed these contracts during the early stages of California's efforts to rapidly develop alternate and renewable energy resources. The prices Edison projected to pay under these 17 contracts were at or below avoided cost over the life of the contracts. Hearings on the 17 contracts have not been scheduled as of this date but will be heard in later proceedings.

In addition to its recommended energy cost disallowance, the DRA has recommended that the CPUC modify its early 1988 decision that authorized Edison to form a holding company. Edison believes that adoption of the DRA's recommendations to modify the holding company decision is not necessary to protect the public interest and will work diligently to demonstrate that it has reasonably administered the contracts under review. CPUC proceedings are scheduled to take place later in 1989.

Balsam Meadow Hydroelectric Project In October 1988, the CPUC's Division of Ratepayer Advocates completed a review of the costs for the 207-MW Balsam Meadow hydroelectric project. The DRA found that Edison had prudently constructed the project and recommended that the entire amount of its investment be covered in customer rates. A decision by the CPUC is expected in May 1989.

Fuel and Purchased Power Rate Adjustments The CPUC periodically reviews the reasonableness of fuel and purchased-power costs and adjusts rates to reflect changes in Edison's costs. Based on the utility's forecast of higher energy costs from June 1988 through May 1989, the CPUC adjusted rates twice in 1988, granting a $200-million revenue increase effective June 1, and an additional $265-million increase effective October 1.

Suspension of Incentive For Fuel and Purchased-Power Expenses On June 1, 1988, the CPUC suspended the annual energy rate (AER) that was established in 1981 to provide utilities a regulatory incentive to minimize fuel and purchased-power expenses. Under the AER, utilities are rewarded for keeping fuel and purchased-power expenses below the levels authorized by the CPUC, and are at risk for such costs that exceed those levels. This temporary suspension was ordered because uncertain natural-gas supplies and prices beyond Edison's control resulted in wide cost fluctuations. The AER is expected to be reinstated on January 1, 1990.

Devers-Valley-Serrano Transmission Line In November 1988, the CPUC's Division of Ratepayer Advocates completed a review of the costs of the 500-KV Devers-Valley-Serrano Project, which became operational in mid-1987. The DRA found that Edison had prudently constructed the project, and that the full amount should be collected in customer rates. A decision by the commission is expected in May 1989.

Devers-Palo Verde No. 2 Transmission Line The CPUC has conditionally approved Edison's request to build the Devers-Palo Verde No. 2 transmission line. Scheduled for operation in June 1993, this transmission line would increase access to Southwest power markets for Edison and 11 other California utilities. The project must be re-evaluated in the context of the proposed Edison-San Diego Gas and Electric (SDG&E) merger before construction can begin.

Federal Energy Regulatory Commission Proposal In mid-1987, the chairman of the Federal Energy Regulatory Commission (FERC) announced that the commission would consider changes to its rules implementing the Federal Power Act and the Public Utility Regulatory Policies Act. These changes would essentially deregulate new sources of nonutility electrical generation by creating a new special class of generation called "independent power producers."

Edison opposes many of these proposed changes that are inconsistent with the Federal Power Act, because they discriminate against utility customers. In addition, they would reduce the long-term reliability of the nation's electricity supply. The issue is still pending before the FERC and at year-end, the U.S. House of Representatives and U.S. Senate were reviewing the matter.

Seasonal Rate Effects Edison petitioned the CPUC to modify an earlier decision relating to a new seasonal rate structure. The rate structure was intended to encourage conservation and load management by creating higher rates during summer and lower rates the rest of the year for many commercial, industrial and agricultural customers.

However, the new seasonal rate structure had the effect of distorting the company's quarterly earnings patterns, although it did not affect Edison's overall 1988 earnings. SCEcorp's 1988 third-quarter summertime earnings, for example, were 85% higher than earnings in the third quarter of 1987, while earnings in the first, second and fourth quarters were significantly lower. Without the seasonal charge, third-quarter earnings would have increased only 3%. The CPUC will review Edison's request to modify the rate structure in 1989.

Clean-Air Plan The South Coast Air Quality Management District, which includes the counties of Los Angeles, Orange, Riverside and San Bernardino, has presented a plan to bring the Los Angeles Basin into compliance with federal air-quality standards by the year 2007. The plan would impose unreasonably high costs on Edison customers by requiring that Edison install uneconomic and unproven new technology on its oil- and gas-fired generating plants. Edison has joined with other businesses in the Los Angeles Basin in presenting an alternative plan that would achieve the compliance goals in 10 years instead of 20, and at one-third the cost to consumers and the economy compared with the district's plan. Edison will continue to participate in the district's public-review process in the hope of saving Edison customers unnecessary costs, preventing an adverse economic impact on the area and working to comply with federal air-quality standards.

Merger Filing In mid-December, Edison and SDG&E filed joint applications with the CPUC and the FERC, seeking approval of the merger of SDG&E into Edison. Hearings are expected to begin in mid-1989. Edison and SDG&E will be seeking regulatory approval for the merger from other agencies in 1989. As is typically the case in these matters, there have been a number of intervenors in both the state and federal proceedings.

Legislative Review

Price-Anderson Nuclear Liability Act In August, the President signed a bill extending the Price-Anderson Act for 15 years. Although the act increases insurance costs for nuclear utilities, it provides a tenfold increase in financial protection to the public in the unlikely event of a major accident at a nuclear power plant in the United States. At the same time, the act's $7.6-billion level of potential compensation that is available to the public serves to limit financial liability for operators of nuclear power plants.

Under the extension, owners of the 109 operating nuclear reactors in the United States must continue to carry the maximum available private insurance coverage for an accident at one of their own reactors. This maximum coverage was increased to $200 million per reactor at the end of 1988. If damages were to exceed the private insurance coverage, Price-Anderson would provide additional funds by levying assessments of up to $63 million per reactor against all nuclear plant owners. Under the new law, the per-reactor assessments would be limited to $10 million annually until the $63-million limit is met.

A Review of Nonutility Subsidiaries: The Mission Group

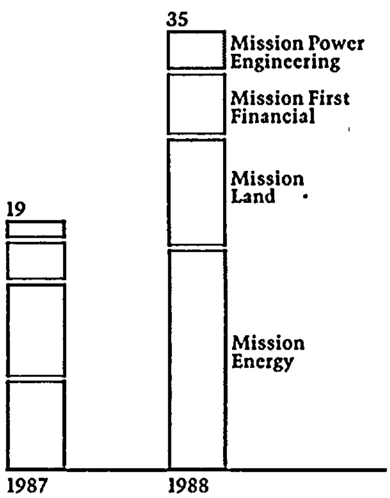
The Mission Group was formed in 1987 to manage the corporation's four principal nonutility subsidiaries, which are primarily engaged in energy-related businesses. Since then, these subsidiaries have continued to pursue business opportunities and now operate in eight states.

At year-end, SCEcorp's equity investment in The Mission Group totaled $505.4 million. Revenues for 1988 were $333.1 million, producing a net income of $77.8 million, or 35 cents per share. This compares with 1987 revenues of $107.6 million, which produced a net income of $41.3 million, or 19 cents per share.

Mission Group earnings represent 10.0% of SCEcorp's 1988 earnings, compared with 5.6% the previous year.

Nonutility Earnings Per Share

Cents per share



Mission Energy Company

Mission Energy is a national leader in the ownership, development and operation of major cogeneration projects. It provides management of engineering and construction, operation and maintenance, and assistance in obtaining permitting and financing for power facilities. Mission Energy concentrates on joint-venture projects with low technological risk, sound economics, and well-established partners.

At the end of 1988, Mission Energy jointly owned and operated nine projects with 1,300 megawatts (MW) of capacity in three states. Five of those projects, with a total of 830 MW of capacity, began operation during 1988. The three largest are the 385-MW Watson cogeneration plant in Carson, California, the 300-MW Sycamore cogeneration plant and the 300-MW Kern River cogeneration plant, both near Bakersfield, California. Another four projects with 330 MW of capacity are under construction.

Mission Energy is the largest of The Mission Group subsidiaries. Revenues for 1988 were $88.2 million, producing a net income of $38.6 million, or 18 cents per share. This compares with 1987 revenues of $38.2 million, producing a net income of $16.4 million, or 7.5 cents per share. At year-end, equity investment in the company totaled $265.7 million.

Mission First Financial Company

Mission First Financial provides energy-related venture capital and invests in leveraged-leasing transactions, project financing, and high-quality securities. This subsidiary holds financial interests in Beaver Valley Nuclear Unit 2 near Pittsburgh, Pennsylvania, and a paper mill and cogeneration facility developed through a joint venture with Minnesota Power Company and Pentair, Inc., a Midwestern paper company.

This subsidiary also has developed a customized cash-management program to provide attractive yields on funds held pending longer-term investments. In addition, the company has an equity investment in Metricom, a California-based electronics firm that is developing and marketing a solid-state electric meter and customer communications system.

No new business was consummated in 1988 because of low-lease volume and aggressive pricing by competitors, but the company is well positioned to take advantage of investment opportunities in 1989.

In 1988, Mission First Financial produced substantially higher financial contributions than 1987, because it was the first full year of operation. Revenues for 1988 were $21.7 million, producing a net income of $13.7 million, or 6 cents per share. This compares with 1987 revenues of $10.8 million, producing a net income of $6.8 million, or 3 cents per share. At year-end, equity investment in the company totaled $90.5 million.

Mission Land Company

Mission Land develops industrial parks with medium-sized warehouses and distribution buildings. The firm owns and manages six industrial parks in Southern California and Arizona, which contain more than 2 million square feet of leasable space. In addition, Mission Land has entered into joint ventures in California, Illinois and Indiana.

During 1988, Mission Land completed several major transactions involving the sale of industrial and residential properties. It became a partner with the Lusk Company in the California Commerce Center, the second largest master-planned industrial park in Southern California. Mission Land maintained an average vacancy rate of only 3% in its industrial parks throughout the year, a major accomplishment in a highly competitive market.

Revenues for 1988 were $48.7 million, producing a net income of $20.2 million, or 9 cents per share. This compares with 1987 revenues of $33.2 million, producing a net income of $17.4 million, or 8 cents per share. At year-end, the equity investment in this company totaled $131.5 million.

Mission Power Engineering Company

Mission Power Engineering performs consulting, engineering and construction in the energy field, including electric generating units, transmission lines, and substations. Since its formation in 1984, the company has been awarded contracts with a total value of about $400 million. In 1988, Mission Power Engineering continued to grow as it performed work on 11 new power plants. For its achievements in 1987, the company was ranked 36th out of the top 400 national design and construction firms, according to a 1988 trade publication.

Revenues for 1988 were $174.4 million, producing a net income of $7.6 million, or 3 cents per share. This compares with 1987 revenues of $25.8 million that produced a net income of $1.7 million, or about 1 cent per share. At year-end, equity investment in this subsidiary totaled $14.1 million.

The corporation reported a record financial performance in 1988 and provided shareholders with a competitive return on their investment.

SCEcorp

Record Net Income and Revenues SCEcorp's earnings rose 3.2% to a record $761.8 million in 1988, compared with $738.5 million in 1987, and revenue grew to another record of $6.3 billion, compared with $5.6 billion in 1987.

SCEcorp's earnings per share for 1988 increased 10 cents to a record $3.49 from $3.39 in 1987. This increase is particularly noteworthy because it was achieved despite a reduction by the California Public Utilities Commission (CPUC) in Edison's authorized rate of return on common equity from 13.9% to 12.75%. The reduction, by itself, would have lowered earnings 33 cents per share, but the company overcame this through tight controls on operating expenses, approval by the CPUC of expense levels that more accurately reflect Edison's costs, a CPUC award for favorable coal-plant operating performance, and higher earnings from The Mission Group of nonutility subsidiaries. In December, the CPUC increased the authorized regulatory return on common equity for 1989 to 13.0% from 12.75% because of higher interest rates facing the utility.

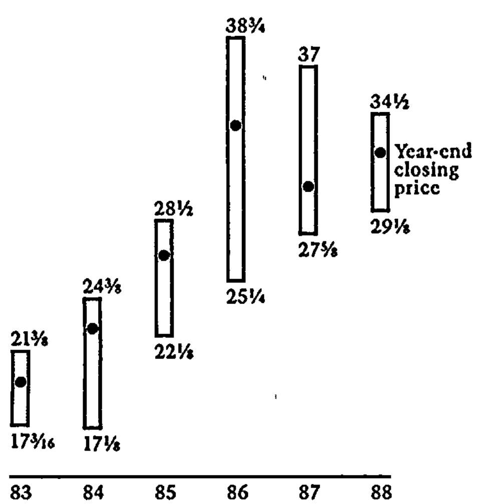
The Mission Group earnings per share for 1988 were 35 cents, or 10.0% of SCEcorp's total earnings, compared with 19 cents per share, or 5.6%, for 1987. Nonutility earnings increased 84% above those in 1987, with earnings growing in each nonutility business. Higher earnings resulted from Mission Energy bringing 830 megawatts of new cogeneration and geothermal projects into operation, the sale of industrial and residential property by Mission Land, increased construction activity by Mission Power Engineering, and a full year of operation for Mission First Financial.

Dividend Increase The board of directors in June increased the common stock dividend for the 13th time in 12 years. The new annual dividend rate of $2.48 per share is 4.2% higher than the previous year's $2.38. The current dividend provided a 7.7% yield, based on a year-end market price of $32⅜ per share.

Total Shareholder Return The return to SCEcorp common shareholders from stock price appreciation and dividends was 14.1% in 1988. The annual return has averaged more than 19% for the past 5-year and 10-year periods, exceeding the Dow Jones industrial and utility averages, as well as the S&P 500 index.

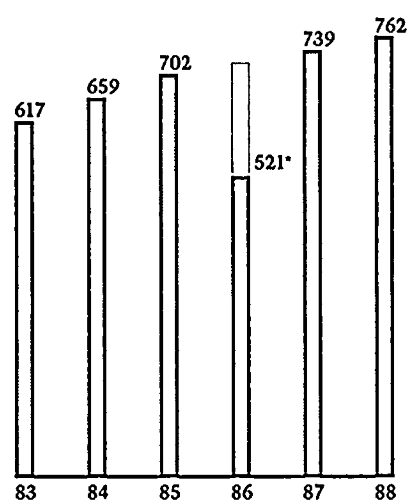
Stock Price Range (SCEcorp)

In dollars



Net Income (SCEcorp)

In millions of dollars



*Reflects restatement for nuclear plant disallowance

Southern California Edison Company

Financial and Regulatory Returns The CPUC authorizes Edison to earn a return on its regulatory rate base, which is the value of assets used to serve customers. This authorized regulatory return is designed to allow the utility to recover its cost of capital, which is composed of long-term debt, preferred stock and the authorized regulatory return on common equity.

In 1988, Edison's authorized regulatory return on rate base was 10.75%, and its authorized regulatory return on common equity was 12.75%. The company's recorded regulatory return on rate base was 10.6%, and its recorded regulatory return on common equity was 12.2%.

However, SCEcorp's recorded financial return on common equity, as shown in financial reports, is based on the holding company's total operations. Several items can cause it to differ from Edison's authorized regulatory return on common equity. In 1988, these factors included earnings from nonutility subsidiaries; federal investment tax credits; and CPUC-established awards for high output from the utility's two coal-fired power plants. In 1988, the corporation's recorded financial return on common equity was 15.3%, compared with 15.5% in 1987.

Corporate Financing In 1988, Edison internally generated 100% of the funds it needed to meet capital requirements, its highest percentage in more than 30 years. The utility raised $663 million in U.S. capital markets during the year, primarily to finance the redemption of more costly debt, repay maturing bonds and meet sinking-fund requirements.

Credit-Line Restructuring Edison lowered the cost of its credit lines in July by arranging for a $300-million line of credit through a syndicate of foreign banks. This was the lowest-cost European credit line negotiated by any U.S. utility in 1988. Edison also renegotiated the cost and structure of its existing $1.6 billion in credit lines.

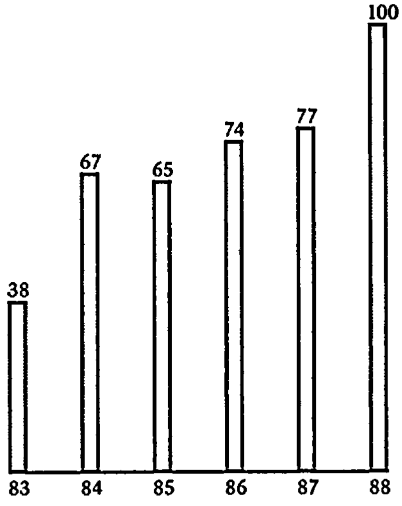
By negotiating these credit arrangements, Edison will save its customers $600,000 annually while maintaining $1.9 billion in credit lines with 40 domestic and foreign banks to meet a variety of financial obligations.

Credit Watch Edison's early warning credit-watch system, the first of its kind in the utility industry, continued to reduce the number of bad-debt write-offs by early identification of high-risk commercial and industrial customers in danger of business failure. The system saves money for customers by ensuring that Edison's revenues are protected through deposits of cash, posting of surety bonds or more frequent payments by these customers.

In 1988, the early warning system reduced potential bad debt by $860,000. It has avoided potential losses of $8 million since it began seven years ago.

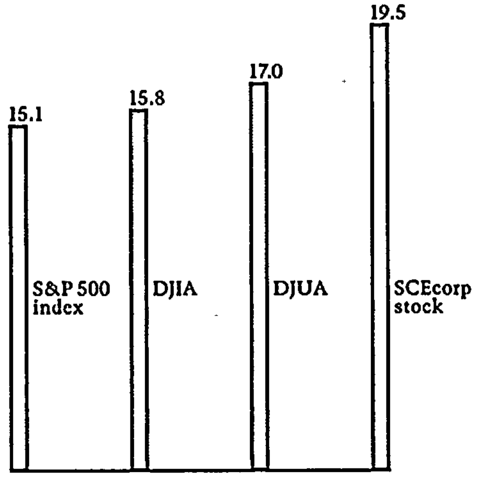
Internal Generation of Funds (Utility)

In percent



5-Year Annual-Return Comparison (Stock price appreciation and dividends)

In percent



Responsibility for Financial Reporting

The management of SCEcorp (the "corporation") is responsible for preparing the accompanying consolidated financial statements. The statements were prepared in accordance with generally accepted accounting principles and include amounts based on management's estimates and judgments. Management also is responsible for the accuracy of all other information in the annual report, including its consistency with the financial statements.

The corporation's consolidated financial statements have been audited in accordance with generally accepted auditing standards by Arthur Andersen & Co., a firm of independent public accountants, which has expressed its opinion regarding the fairness of these consolidated financial statements in the accompanying report.

The management of the corporation and its subsidiaries maintains systems of internal control that provide reasonable assurance that assets are safeguarded, transactions are properly executed in accordance with management's authorization, and accounting records may be relied upon for the preparation of financial statements and other financial information. The design of internal control systems involves management's judgment concerning the relative cost and expected benefits of specific control measures. These systems are augmented by internal audit programs through which the adequacy and effectiveness of internal controls, policies and procedures are evaluated and reported to management. In addition, Arthur Andersen & Co., as part of its audit of the corporation's consolidated financial statements, evaluates the internal control structure to determine the nature, timing and extent of its audit tests. Management believes the corporation's and its subsidiaries' systems of internal control are adequate to accomplish the objectives discussed herein.

The Audit Committee of the Board of Directors, composed entirely of nonemployee directors, meets periodically with the independent public accountants, internal auditors and management. This committee, which recommends to the Board of Directors the annual appointment of the independent public accountants, also considers the audit scope and nature of other services provided, discusses the adequacy of internal controls, reviews financial reporting issues and is advised of management's actions regarding these matters. Both the independent public accountants and internal auditors have unrestricted access to the Audit Committee.

Management also is responsible for fostering a climate in which the corporation's and its subsidiaries' affairs are conducted in accordance with the highest standards of personal and corporate conduct. This high ethical standard is reflected in the corporation's Standards of Conduct, which are distributed periodically to all employees of the corporation and its subsidiaries. The Standards of Conduct address, among other things, complying with all laws and regulations applicable to the corporation's and its subsidiaries' business, avoiding potential conflicts of interests, and maintaining the confidentiality of proprietary information. The management of the corporation and its subsidiaries maintains programs to assess compliance with these standards.

John E. Bryson
Executive Vice President and Chief Financial Officer

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

February 6, 1989

Report of Independent Public Accountants

To the Shareholders and the Board of Directors, SCEcorp:

We have audited the accompanying consolidated balance sheets and statements of capitalization of SCEcorp (a California corporation hereinafter referred to as the "corporation") and its subsidiaries as of December 31, 1988, and 1987, and the related consolidated statements of income, retained earnings and cash flows for each of the three years in the period ended December 31, 1988. These financial statements are the responsibility of the corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the corporation and its subsidiaries as of December 31, 1988, and 1987, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1988, in conformity with generally accepted accounting principles.

As discussed in Notes 1 and 2 to the accompanying financial statements, the corporation has given retroactive effect to its restructuring, which took place on July 1, 1988, and to the change in the method of accounting for its majority-owned subsidiaries. Also, as discussed in Notes 2 and 3 to the financial statements, the corporation changed its method of accounting for unbilled revenues as of January 1, 1987, and, effective January 1, 1988, retroactively changed its method of accounting for disallowances of plant costs.

Arthur Andersen & Co.

ARTHUR ANDERSEN & CO.

Los Angeles, California
February 6, 1989

Consolidated Statements of Income

SCEcorp and Subsidiaries

In thousands, except per share amounts Year ended December 31,	1988	1987	1986
Electric revenue	$5,931,682	$5,501,057	$5,316,325
Investment and other	321,037	100,869	51,762
Total operating revenue	6,252,719	5,601,926	5,368,087
Fuel	972,973	1,091,973	865,376
Purchased power	1,235,110	780,599	775,814
Provisions for regulatory adjustment clauses—net	240,681	225,108	225,539
Other operating expenses	1,068,886	885,849	846,652
Maintenance	375,444	361,484	353,170
Depreciation and decommissioning	646,569	551,348	507,503
Income taxes	446,395	578,228	702,442
Property and other taxes	170,293	162,546	144,435
Total operating expenses	5,156,351	4,637,135	4,420,931
Operating income	1,096,368	964,791	947,156
Nuclear plant disallowance *(Note 3)*	—	(148,963)	(269,883)
Income taxes—nuclear plant disallowance	—	78,616	61,665
Provision for phase-in plan	170,856	137,832	88,672
Allowance for equity funds used during construction	18,125	73,406	105,744
Interest income	121,708	93,213	110,971
Taxes on nonoperating income	(79,547)	(80,490)	(35,654)
Other—net	(162)	20,144	25,320
Total other income—net	230,980	173,758	86,835
Income before interest and other expenses	1,327,348	1,138,549	1,033,991
Interest on long-term debt and amortization	439,842	404,767	433,103
Other interest expense	108,498	82,059	83,274
Allowance for borrowed funds used during construction	(11,883)	(42,926)	(29,478)
Capitalized interest	(17,636)	(25,933)	(28,319)
Preferred and preference stock dividend requirements of subsidiary	46,696	50,095	54,684
Total interest and other expenses—net	565,517	468,062	513,264
Income before cumulative effect of a change in accounting principle	761,831	670,487	520,727
Cumulative effect on prior years (to December 31, 1986) of accruing unbilled revenue—net of income taxes of $58,752,000 *(Note 2)*	—	68,044	—
Net income	$ 761,831	$ 738,531	$ 520,727
Weighted-average shares of common stock outstanding (000)	218,332	218,014	217,780
Earnings per share *(Note 2):*			
Before cumulative effect of a change in accounting principle	$3.49	$3.08	$2.39
Cumulative effect of a change in accounting principle	—	.31	—
Total earnings per share	$3.49	$3.39	$2.39

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

Consolidated Balance Sheets

SCEcorp and Subsidiaries

In thousands December 31,	1988	1987
ASSETS		
Utility plant, at original cost *(Note 3)*	$15,687,850	$14,465,691
Less—Accumulated provision for depreciation and decommissioning *(Note 3)*	4,529,938	3,993,468
	11,157,912	10,472,223
Construction work in progress	676,175	1,232,990
Nuclear fuel, at amortized cost	475,764	547,786
	12,309,851	12,252,999
Less—Property-related accumulated deferred income taxes	914,532	840,143
Total utility plant	11,395,319	11,412,856
Nonutility property—less accumulated provision for depreciation of $22,570,000 and $130,681,000 at respective dates	107,851	105,850
Nuclear decommissioning trusts, at cost	157,086	—
Investments in partnerships	480,458	286,006
Investments in leveraged leases	148,027	128,858
Other investments	31,978	26,483
Total other property and investments	925,400	547,197
Cash and equivalents	228,367	163,426
Receivables, including unbilled revenue, less allowances of $13,187,000 and $15,355,000 for uncollectible accounts at respective dates	700,343	625,789
Fuel stock	125,303	118,540
Materials and supplies, at average cost	96,767	105,577
Regulatory balancing accounts—net	395,026	621,635
Prepayments and other current assets	113,556	80,474
Total current assets	1,659,362	1,715,441
Unamortized debt issuance and reacquisition expense	296,094	301,741
Rate phase-in plan	435,941	239,760
Other deferred charges	154,160	133,669
Total deferred charges	886,195	675,170
Total assets	$14,866,276	$14,350,664

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

In thousands December 31,	1988	1987
CAPITALIZATION AND LIABILITIES		
Common shareholders' equity *(Note 3)*	$ 5,064,848	$ 4,833,734
Preferred and preference stock of subsidiary:		
Not subject to mandatory redemption	358,755	361,238
Subject to mandatory redemption	239,037	277,538
Long-term debt of subsidiaries	5,421,747	5,150,883
Total capitalization *(see accompanying statements)*	11,084,387	10,623,393
Other long-term liabilities	136,810	113,348
Current portion of subsidiaries' long-term debt and redeemable subsidiary preferred and preference stock	165,975	101,555
Short-term debt	658,418	672,501
Accounts payable	464,817	458,048
Accrued taxes	435,030	471,008
Accrued interest	117,477	106,666
Dividends payable	139,187	133,281
Accumulated deferred income taxes—net	166,754	236,662
Deferred unbilled revenue and other	304,470	354,184
Total current liabilities	2,452,128	2,533,905
Accumulated deferred investment tax credits	545,728	555,676
Accumulated deferred income taxes—net	398,827	248,690
Customer advances and other deferred credits	248,396	275,652
Total deferred credits	1,192,951	1,080,018
Commitments and contingencies *(Notes 1, 3, 8, 9, and 10)*		
Total capitalization and liabilities	$14,866,276	$14,350,664

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

Consolidated Statements of Cash Flows

SCEcorp and Subsidiaries

In thousands Year ended December 31,	1988	1987	1986
Cash flows from operating activities:			
Net income	$ 761,831	$ 738,531	$ 520,727
Adjustments for noncash items:			
Depreciation and decommissioning	646,569	551,348	507,503
Amortization	156,732	157,304	129,800
Nuclear plant disallowance—net	—	70,347	208,218
Allowance for funds used during construction	(30,008)	(116,332)	(135,222)
Rate phase-in plan	(196,181)	(149,110)	(90,650)
Regulatory deferrals—energy exploration projects	—	61,637	21,748
Deferred income taxes and investment tax credits	176,614	198,417	281,863
Equity in income from partnerships	(87,070)	(51,739)	(21,319)
Income from leveraged leases	(17,056)	(10,289)	—
Other—net	(20,420)	22,443	8,390
Changes in working capital components:			
Receivables	(74,554)	(241,227)	(41,445)
Regulatory balancing accounts	226,609	(31,548)	17,120
Fuel stock, materials and supplies	2,047	133,518	5,584
Prepayments and other current assets	(12,689)	(3,713)	31,860
Accrued interest and taxes	(63,314)	8,607	222,418
Accounts payable and other current liabilities	(43,292)	267,883	38,784
Net cash provided by operating activities	1,425,818	1,606,077	1,705,379
Cash flows from financing activities:			
Issuances of long-term debt	631,343	374,787	1,472,532
Repayment of long-term debt	(350,383)	(325,967)	(1,595,936)
Redemption of subsidiary preferred and preference stock	(48,775)	(17,712)	(200,525)
Nuclear fuel financing	(18,569)	(56,191)	(46,518)
Short-term debt financings—net	51,917	182,461	231,750
Dividends paid	(530,409)	(507,808)	(484,320)
Net cash used by financing activities	(264,876)	(350,430)	(623,017)
Cash flows from investing activities:			
Construction expenditures	(834,630)	(1,034,348)	(1,158,243)
Contributions to decommissioning funds	(157,086)	—	—
Investments in leveraged leases—net	(200)	(102,865)	—
Investments in partnerships	(168,332)	(164,037)	(19,884)
Distributions from partnerships	55,998	37,838	—
Proceeds from sale of assets	27,637	23,900	—
Other—net	(19,388)	(18,217)	11,289
Net cash used by investing activities	(1,096,001)	(1,257,729)	(1,166,838)
Increase (decrease) in cash and equivalents	64,941	(2,082)	(84,476)
Cash and equivalents, beginning of year	163,426	165,508	249,984
Cash and equivalents, end of year	$ 228,367	$ 163,426	$ 165,508
Noncash investing and financing activities:			
Conversion of subsidiary 5.20% convertible preference stock	$2,108	$ 414	$ 845
Conversion of subordinated debentures	2,973	3,136	2,849
Conversion of partnership notes to equity	—	18,670	—

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

Consolidated Statements of Capitalization

SCEcorp and Subsidiaries

Notes to consolidated statements of capitalization are on Page 32.

In thousands			December 31,	1988	1987
Common shareholders' equity:					
Common stock—no par value—400,000,000 shares authorized; 218,461,932 and 218,134,481 outstanding at respective dates (b)				$ 2,463,762	$ 2,457,819
Retained earnings *(See accompanying statements)*				2,601,086	2,375,915
Total				5,064,848	4,833,734
Preferred and preference stock of subsidiary:		December 31, 1988			
Not subject to mandatory redemption (c) (d):	Series	Shares Outstanding	Redemption Price		
Cumulative preferred:					
$25 par value:	4.08%	1,000,000	$ 25.50	25,000	25,000
	4.24	1,200,000	25.80	30,000	30,000
	4.32	1,653,429	28.75	41,336	41,336
	4.78	1,296,769	25.80	32,419	32,419
	5.80	2,200,000	25.25	55,000	55,000
$100 par value:	7.58	750,000	101.00	75,000	75,000
	8.70	500,000	104.00	50,000	50,000
	8.96	500,000	104.00	50,000	50,000
Preference:					
$25 par value:	5.20 convertible	—	—	—	2,483
Total				358,755	361,238
Subject to mandatory redemption (c) (e):					
Cumulative preferred:					
$100 par value:	7.325%	547,381	$103.54	54,738	60,000
	7.80	483,495	104.62	48,350	51,000
	8.54	615,000	105.65	61,500	63,750
	8.70A	433,124	110.00	43,312	45,937
	12.31	430,000	105.83	43,000	50,000
Preference:					
$25 par value:	7.375	—	—	—	28,864
Preferred and preference stock to be redeemed within one year				(11,863)	(22,013)
Total				239,037	277,538
Long-term debt of subsidiaries:					
	Maturity	Interest rates			
First and refunding mortgage bonds (c)(f):					
	1989 through 1992	4⅜% to 8¾%		475,000	672,000
	1993 through 1997	6⅜% to 9%		1,125,000	1,000,000
	1998 through 2002	8¼% to 9%		650,000	500,000
	2003 through 2007	9⅝% to 9.95%		278,750	284,000
	2008 through 2020	8⅜% to 13%		1,267,476	1,084,413
Pollution control bonds (c) (g):	1999 through 2015	6¾% to 10¼% and variable		947,730	897,730
Funds held by trustees				(11,119)	(10,472)
Debentures and notes (d)(e)(h):	1990 through 1999	8.25% to 11% and variable		441,698	438,528
Nuclear fuel indebtedness (e) (i)				424,168	379,029
Long-term debt due within one year (e)				(154,112)	(79,542)
Unamortized debt discount—net				(22,844)	(14,803)
Total				5,421,747	5,150,883
Total capitalization				$11,084,387	$10,623,393

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

(a) Effective July 1, 1988, SCEcorp became the parent holding company of Southern California Edison Company (Edison) and The Mission Group. Holders of Edison common stock became holders of SCEcorp common stock on a share-for-share basis. The California Public Utilities Commission's (CPUC) decision authorizing the establishment of a holding company requires Edison to maintain a capital structure consistent with the CPUC's most recently authorized capital structure.

(b) At December 31, 1988, 1,490,000 shares of common stock were reserved for issuance under the 1987 Long-Term Incentive Compensation Plan.

(c) In connection with the formation of SCEcorp, each outstanding share of Edison's original preferred stock was converted into 2.1 shares of SCEcorp's common stock. Edison's authorized shares of $25 cumulative preferred, $100 cumulative preferred, $25 preference and $100 preference stock are 24,000,000, 12,000,000, 10,000,000, and 2,000,000 shares, respectively. All series of cumulative preferred and preference stock are redeemable. The 430,000 shares of $100 cumulative preferred stock, 12.31% Series, are not subject to redemption until May 1, 1992. The various series of $100 cumulative preferred stock are subject to certain restrictions on redemption for refunding purposes.

(d) On May 31, 1988, Edison either redeemed or converted its outstanding shares of 5.20% convertible preference stock at $25 per share and converted all of the outstanding 12½% convertible debentures at the conversion price of $16.1875.

(e) The table below presents the mandatory redemption requirements for preferred stock, long-term debt maturities and sinking fund requirements for the five years subsequent to December 31, 1988:

	Year ended December 31,				
In thousands	1989	1990	1991	1992	1993
Preferred stock redemption requirements	$ 11,863	$ 11,738	$ 11,738	$ 11,738	$ 12,338
Long-term debt maturities and sinking fund requirements	154,112	212,905	204,737	222,157	242,535
Total	$165,975	$224,643	$216,475	$233,895	$254,873

(f) Substantially all utility properties are subject to the liens of trust indentures, except for nuclear fuel and fuel oil inventories, which are financed with short-term debt in conformity with CPUC ratemaking procedures.

(g) Edison has issued first and refunding mortgage bonds and other indebtedness to governmental agencies in exchange for proceeds from pollution control bonds. These proceeds have been deposited with trustees and are used to finance construction of pollution control facilities. Certain pollution control bonds may be redeemed at the discretion of the bondholders. Edison has made arrangements with security dealers for the remarketing or purchase of the pollution control bonds in such cases. Edison arranged lines of credit for $600 million at December 31, 1988, to refinance these bonds, should remarketing be unsuccessful.

(h) One of SCEcorp's unregulated subsidiaries has debt outstanding in the amount of $99.0 million at December 31, 1988, and $107.0 million at December 31, 1987, supported by lines of credit aggregating $280.0 million at December 31, 1988, and $235.0 million at December 31, 1987.

(i) Nuclear fuel financing is comprised of:

	December 31,	
In thousands	1988	1987
Foreign-currency-denominated notes(1)	$ 62,950	$ 66,000
Commercial paper(2)	338,777	288,296
Spent nuclear fuel obligation(3)	22,441	24,733
	424,168	379,029
Less: Current maturities	65,494	2,292
Total	$358,674	$376,737

(1) Edison issued foreign-currency-denominated notes totaling $60.4 million in September 1987 to finance nuclear fuel. The notes mature 24 months from the date of issuance. Under a currency-exchange agreement, a securities firm assumes all foreign-currency translation gains and losses. Weighted-average interest rates on the notes are based on the average daily commercial paper rate and were 7.46% for 1988 and 7.09% for 1987. Foreign-currency translation gains or losses have been deferred and are included in the translated value of the liability.

(2) A portion of the commercial paper used to finance nuclear fuel has been classified as long-term debt under refinancing agreements with commercial banks. The long-term portion finances nuclear fuel not scheduled for consumption within 12 months of the balance sheet dates.

(3) Pursuant to the Nuclear Waste Policy Act of 1982, Edison has signed a contract with the U.S. Department of Energy for disposal of spent nuclear fuel from the San Onofre Nuclear Generating Station. The interest rate is fixed at 10.57%.

Consolidated Statements of Retained Earnings

SCEcorp and Subsidiaries

In thousands, except per share amounts Year ended December 31,	1988	1987	1986
Balance at beginning of year	$2,375,915	$2,150,751	$2,128,646
Net income	761,831	738,531	520,727(a)
Dividends declared on common stock	(536,660)	(513,367)	(489,909)
Loss on reacquired capital stock and other	—	—	(8,713)
Balance at end of year	$2,601,086(b)	$2,375,915	$2,150,751
Dividends declared per common share	$2.45½	$2.35½	$2.25

(a) Restated from $713,933,000 to $520,727,000 to reflect the after-tax write-off of nuclear plant disallowances totaling $193,206,000. (See Note 3 of "Notes to Consolidated Financial Statements").

(b) Includes appropriated retained earnings related to certain federally licensed hydroelectric projects of $4,468,000 at December 31, 1988.

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

Notes to Consolidated Financial Statements

SCEcorp and Subsidiaries

Note 1. Corporate Restructuring and Proposed Merger

On July 1, 1988, SCEcorp acquired the outstanding common stock of Southern California Edison Company (Edison) under a merger agreement approved by shareholders on April 21, 1988. Edison shareholders became holders of SCEcorp's common stock on a share-for-share basis. Each share of Edison's outstanding original preferred stock was converted into 2.1 shares of SCEcorp's common stock. Edison's remaining preferred stock and debt securities were not exchanged or transferred to SCEcorp. Edison's equity investment in non-utility subsidiaries was transferred to SCEcorp at book value on July 1, 1988.

On November 30, 1988, SCEcorp, Edison, and San Diego Gas & Electric Company (SDG&E) executed an agreement to merge SDG&E into Edison. Under the terms of the merger agreement, SCEcorp will exchange 1.3 shares of its newly issued common stock for each SDG&E common share. SDG&E preferred and preference stock will be exchanged for SCEcorp preferred and preference stock with similar provisions, except that dividends on each series will be increased between 2.5% and 20%. The merger is subject to approval by the shareholders of SCEcorp, Edison, and SDG&E, as well as regulatory agencies, including the California Public Utilities Commission (CPUC) and the Federal Energy Regulatory Commission (FERC).

Note 2. Summary of Significant Accounting Policies

Consolidation Policy The consolidated financial statements include the accounts of SCEcorp and its subsidiaries. The principal subsidiaries are Edison and The Mission Group, which is the parent company for all subsidiaries not subject to rate regulation. SCEcorp uses the equity method of accounting to report investments of 50% or less in partnerships primarily engaged in cogeneration, geothermal and other energy-related facilities which are exempt from utility regulation. All significant intercompany transactions have been eliminated, except intercompany profits from energy sales to Edison by unregulated, energy-producing affiliates, which are allowed in rates.

Accounting Principles Edison is regulated by the CPUC and the FERC. The accompanying consolidated financial statements reflect the ratemaking policies of these commissions, as applied to Edison, in conformity with generally accepted accounting principles applicable to rate-regulated enterprises.

Utility Plant The costs of plant additions, including replacements and betterments, are capitalized and included in utility plant. Capitalized costs include direct material and labor, construction overhead, and an allowance for debt and equity funds used to finance construction. The cost of property that is replaced or retired—and related removal costs, less salvage—is charged to the accumulated provision for depreciation. Accumulated deferred income taxes related to utility plant are presented as a deduction from utility plant to conform with ratemaking procedures used to determine rate base.

Construction Financing Costs Allowance for funds used during construction (AFUDC) represents the cost of debt and equity funds that finance construction of utility plant. Capitalized AFUDC is reported in the consolidated statements of income as a reduction of interest charges for the debt component and as other income for the equity component. AFUDC and plant construction costs are recovered when completed projects are placed into commercial operation, and the recovery of related depreciation is authorized through customer rates.

Before 1987, the cost of debt included in the AFUDC calculation was reduced by the tax benefit realized from deducting the related interest expense from taxable income. As a result of changes in the treatment of interest expense for income tax purposes, pretax interest expense was used to compute the debt component of AFUDC beginning in 1987. The AFUDC rate, which reflects semiannual compounding, was 10.76% for 1988 and 11.57% for 1987 under the pretax method. The rate was 10.53% for 1986 under the previous net-of-tax method.

Interest on loans that finance partnership construction projects is capitalized until the projects are operational. Such capitalized interest is included in investments in partnerships in the consolidated balance sheets.

Depreciation and Decommissioning Depreciation of utility plant, except nuclear fuel, is computed on a straight-line, remaining-life basis. Depreciation of non-utility properties is computed on a straight-line basis over their estimated useful lives.

The estimated cost of decommissioning Edison's nuclear generating facilities is $713 million and is recovered in rates through annual allowances charged to depreciation expense. Retail rates for 1988, and certain prior years, included annual decommissioning revenue requirements, which have been deposited in trust funds until decommissioning begins. Trust fund contributions are invested in high-grade securities. Approximately 80% of the trust fund contributions qualify as tax deductions.

Nuclear Fuel The cost of nuclear fuel, including its disposal, is amortized on the basis of generation and is charged to fuel expense. In accordance with ratemaking procedures adopted by the CPUC, nuclear fuel financing costs are capitalized until the fuel is placed into production.

Research, Development, and Demonstration (RD&D) RD&D costs not related to a specific project are expensed in the year incurred. RD&D costs related to specific construction projects are capitalized until it is determined whether they will result in construction of plant. If construction does not result, the costs are charged to expense.

RD&D costs are reflected in the following table:

	Year ended December 31,		
In thousands	1988	1987	1986
RD&D costs charged to expense	$43,414	$42,893	$47,122
RD&D costs deferred/capitalized	17,455	14,855	3,888
Total RD&D costs	$60,869	$57,748	$51,010

Commencing in 1988, a balancing account has been established for RD&D costs charged to expense. Under this mechanism, Edison is required to refund to ratepayers any authorized but unspent RD&D funds at the end of the three-year rate-case cycle ending December 31, 1990.

Unamortized Debt Issuance and Reacquisition Expense Debt premium, discount, and issuance expenses are amortized over the lives of the related issuances. The expense of reacquiring bonds that are redeemed without refunding are amortized over the period the debt would have remained outstanding. The reacquisition expenses are amortized over the lives of the new debt issues when debt is reacquired with refunding.

Change in Accounting Principle Prior to 1987, electric operating revenue was recorded based on customer billings. On January 1, 1987, Edison began accruing estimated revenue for electricity that had been delivered to customers through the end of each month but had not yet been billed. This accounting change conforms to the Tax Reform Act of 1986, which requires utilities to include unbilled revenue in taxable income commencing in 1987 and results in a better matching of revenue and expense.

Had the new accounting method been in effect for 1986, net income would have been $2.7 million less than the amount reported, resulting in a one-cent decline in earnings per share.

Regulatory Balancing Accounts

Operating Revenue: The CPUC has authorized an electric revenue adjustment mechanism (ERAM) balancing account to minimize the effect on earnings of retail sales fluctuations. Differences between authorized and recorded base rate revenue are accumulated in the account until they are refunded to or recovered from utility customers through CPUC-authorized rate adjustments.

Energy Costs: An energy cost adjustment clause (ECAC) balancing account adjusts results of operations for variations between the recorded cost of fuel and purchased power and revenue designated for recovery of such costs. Undercollected energy costs are accumulated in the balancing account until they are recovered from utility customers through CPUC-authorized rate adjustments. Previously, 90% of fuel and purchased power costs were recovered through ECAC, and the remaining 10% of such costs were recovered through the annual energy rate (AER). On June 1, 1988, the CPUC suspended the AER rate component. As a result, all fuel and purchased power costs are currently recovered through ECAC.

In 1987, the CPUC authorized a one-time write-down of the cost of fuel oil inventory to market prices. It also authorized the last-in, first-out inventory method for measuring the cost of fuel oil consumption. The $108.7-million write-down, including interest, has been recorded in the ECAC balancing account. On December 31, 1988, the balance remaining to be recovered was $59.0 million, including interest.

The CPUC has established performance incentives based on target generation levels for Edison's nuclear generating stations. Fuel savings or costs attributable to levels above or below the targeted ranges are divided equally between SCEcorp and Edison's customers through adjustments to the ECAC balancing account.

Major Plant Additions: Before 1988, Edison used major additions adjustment clause (MAAC) balancing accounts to accumulate the differences between revenue required to provide recovery of ownership costs of San Onofre Nuclear Generating Station (San Onofre) Units 2 and 3 and Palo Verde Nuclear Generating Station (Palo Verde) Units 1 and 2 and related authorized revenue.

Commencing in 1988, ownership costs of San Onofre Units 2 and 3 are recovered in base rates. The ownership costs of Palo Verde Units 1, 2, and 3 are also recovered in base rates to the extent they are not deferred in accordance with the Palo Verde rate phase-in plan. Recovery of remaining undercollections in the MAAC balancing accounts as of December 31, 1988, has been authorized over a three-year period, beginning in 1989.

Interest and Taxes: Interest on regulatory balancing accounts is accrued at the three-month prime commercial paper rate. The weighted-average interest rates were 7.60% for 1988 and 6.57% for 1987. Income tax effects on the changes in the regulatory balancing accounts are deferred.

Palo Verde Rate Phase-In Plan: Palo Verde Units 1, 2, and 3 have been in commercial operation, for ratemaking purposes, since February 1, 1986, September 19, 1986, and January 20, 1988, respectively. The CPUC has adopted a 10-year rate phase-in plan, which defers $200 million of required revenue during the first four years of operation for each unit. Deferrals for each unit, for years one through four, are $80 million, $60 million, $40 million, and $20 million, respectively. The deferrals and related interest will be recovered on a level basis during the final six years of each unit's phase-in plan.

Statements of Cash Flows Beginning in 1988, SCEcorp presented statements of cash flows in conformity with a new accounting standard. Prior periods have been restated to be consistent with the current presentation. For purposes of the consolidated statements of cash flows, SCEcorp considers short-term temporary cash investments to be cash equivalents. Cash payments for interest were $485.5 million in 1988, $455.1 million in 1987, and $466.3 million in 1986.

Restatements and Reclassifications All prior period financial statements and related notes have been restated to reflect consolidation of all majority-owned subsidiaries and the corporate restructuring. The consolidated financial statements also have been restated to reflect the write-off of utility plant and related adjustments to the accumulated provision for depreciation, accumulated deferred income taxes, and retained earnings resulting from the CPUC's disallowance of nuclear plant construction costs. See Note 3 for a further discussion of the disallowance.

Certain other items in prior periods have also been reclassified to conform them to the financial statement presentations for December 31, 1988.

Note 3. Regulatory Matters

CPUC Disallowances In October 1986, the CPUC disallowed $258.6 million of Edison's $3.4-billion investment in San Onofre Units 2 and 3. Edison filed for rehearing on $213.4 million of the disallowed costs in December 1986. In March 1987, the CPUC granted a rehearing on indirect construction cost issues and, in July 1987, issued a decision that reduced the October 1986 disallowance to $198.9 million.

Recovery of Edison's $1.5-billion investment in Palo Verde was reduced by 19.33% of the amount disallowed for San Onofre Units 2 and 3, under a ratemaking agreement adopted by the CPUC. The CPUC's investment disallowances for San Onofre and Palo Verde total $237 million.

In December 1986, the Financial Accounting Standards Board began requiring regulated enterprises to write off construction costs not allowed in rate base. The new standard provides for the restatement of prior-period financial statements for disallowances occurring before the standard's effective date of January 1, 1988. Accordingly, the 1986 consolidated statement of income includes a one-time, after-tax charge against earnings of approximately $193 million, reflecting the CPUC's final construction-cost disallowances arising from its October 1986 decision.

In addition, revenue accrued to recover prior years' ownership costs, which is associated with the construction costs disallowed by the CPUC, has been written off from the MAAC balancing account. Edison recorded after-tax charges against earnings of approximately $15 million for 1986 and $70 million for 1987.

Energy Cost Proceedings The CPUC's Division of Ratepayer Advocates (DRA) recommended that the CPUC disallow $124 million of energy costs incurred between late 1984 and late 1987. Approximately $120 million of the proposed disallowance represents alleged overpayments to nonutility power producers, including electricity purchased by Edison from a 300-MW cogeneration facility owned by Kern River Cogeneration Company (KRCC). Mission Energy Company, which is one of SCEcorp's nonutility subsidiaries, is a partner in the KRCC facility. The DRA's proposed disallowance in relation to power purchases from KRCC is approximately $37 million. In upcoming CPUC hearings, Edison will demonstrate that the power purchases from KRCC actually saved its customers more than $24 million during the three years under consideration, compared with the "standard offer" contract approved by the CPUC. The DRA also alleges overpayments by Edison under 17 other contracts Edison negotiated with nonutility power producers that are not SCEcorp affiliates. Edison signed these contracts during the early stages of California's efforts to rapidly develop alternate and renewable energy resources. The prices Edison projected to pay under these 17 contracts were at or below avoided cost standard contracts over their lives.

In addition to its recommended energy cost disallowance, the DRA has recommended that the CPUC modify its early 1988 decision that authorized Edison to form a holding company.

Although the probable effect that the outcome of this matter will have on net income cannot be determined at this time, Edison believes that adoption of the DRA's recommendation to modify the holding company decision is not necessary to protect the public interest and Edison will work diligently to demonstrate that it has reasonably administered the contracts under review. CPUC proceedings are scheduled to take place later this year.

Resale Rates In accordance with FERC procedures, resale rates are subject to refund with interest if subsequently disallowed. Edison believes that any refunds resulting from pending rate proceedings, should not have a material effect on net income.

Note 4. Short-Term Debt

SCEcorp maintains unrestricted deposits of approximately $7 million at commercial banks and pays annual commitment fees of up to .1% to maintain lines of credit which may be utilized at negotiated or bank index rates and which totaled $2.2 billion on December 31, 1988. Approximately $1.6 billion of these lines of credit support commercial paper and other borrowings to finance general cash requirements; leveraged leases; fuel inventories; and undercollections in regulatory balancing accounts. The remaining $600 million of these lines of credit are available for the long-term refinancing of certain variable-rate pollution-control indebtedness issued by Edison.

Short-term debt of subsidiaries is comprised of:

	December 31,	
In millions	1988	1987
General purpose	$ 67.1	$ 35.8
Leveraged leases	99.0	107.0
Balancing accounts	400.0	400.0
Fuel	535.3	518.3
Total borrowings supported by lines of credit	1,101.4	1,061.1
Amount reclassified as long-term	(437.8)	(395.3)
Unamortized discount	(5.3)	—
Other short-term borrowings	.1	6.7
Net short-term debt	$ 658.4	$ 672.5

Note 5. Income Taxes

SCEcorp's subsidiaries are included in its consolidated federal income tax and combined state franchise tax returns. Under income tax allocation agreements, each subsidiary calculates its tax liability separately.

Current and Deferred Taxes Income tax expense includes the current tax liability 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.

The current and deferred components of income tax expense are:

	Year ended December 31,		
In thousands	1988	1987	1986
Current:			
Federal	$241,917	$319,429	$342,253
State	107,411	124,055	119,972
	349,328	443,484	462,225
Deferred—federal and state:			
Investment and energy tax credits—net	(11,210)	40,351	69,931
Depreciation	173,380	188,186	176,280
Regulatory balancing accounts	(79,460)	(33,463)	(21,400)
Debt reacquisition expenses	(2,507)	(1,390)	81,968
Leveraged leases	38,950	23,784	—
Fuel contract settlements	(1,980)	16,002	9,528
Nuclear plant disallowance	—	(78,616)	(61,665)
Cumulative effect of accounting change	—	58,752	—
Capitalized exploration and development expenses	—	—	(31,338)
Unbilled revenue	(24,420)	(27,467)	—
Phase-in plan	78,743	68,797	46,398
Fixed charges	7,994	(14,178)	(45,538)
Contributions in aid of construction	(28,836)	(14,000)	—
Other	25,960	(31,388)	(9,958)
	176,614	195,370	214,206
Total income tax expense	$525,942	$638,854	$676,431

Classification of income taxes:			
Included in operating expenses	$446,395	$578,228	$702,442
Included in other income	79,547	80,490	35,654
Nuclear plant disallowance	—	(78,616)	(61,665)
Related to cumulative effect of accounting change	—	58,752	—
Total income tax expense	$525,942	$638,854	$676,431

Accumulated deferred investment tax credits (ITC) are amortized over the lives of the related properties.

Cash payments for income taxes were $421.9 million in 1988, $466.7 million in 1987, and $316.3 million in 1986.

The following table reconciles the differences between recorded state and federal income taxes and amounts determined on income before taxes by applying the federal statutory tax rate. The federal and composite federal and state statutory income-tax rates are 34% and 40.138%, respectively, for 1988; 40% and 46.138%, respectively, for 1987; and 46% and 51.184%, respectively, for 1986.

	Year ended December 31,		
In thousands	1988	1987	1986
Expected federal income tax expense at statutory rate	$ 437,843	$ 550,954	$ 550,693
Increase (decrease) in income tax expense resulting from:			
Allowance for equity and borrowed funds used during construction	(6,163)	(29,362)	(62,202)
Federal deduction for state taxes on income	(40,005)	(49,480)	(54,493)
Depreciation timing difference not deferred	70,224	96,042	102,536
State tax provision	117,662	123,700	118,464
Prior years' decommissioning	(15,714)	—	—
Nuclear plant disallowance	—	(4,730)	55,042
Subsidiary preferred and preference dividends	15,876	20,038	25,155
All other differences	(53,781)	(68,308)	(58,764)
Total income tax expense	$ 525,942	$ 638,854	$ 676,431
Pretax income	$1,287,773	$1,377,385	$1,197,158
Effective tax rate (total income tax expense ÷ pretax income)	40.8%	46.4%	56.5%

Deferred income taxes for tax depreciation prior to 1981 and certain construction overheads have not been provided because the tax effects of such timing differences are not allowed for retail ratemaking purposes until the taxes become payable. The cumulative net amount of these timing differences was $1.8 billion on December 31, 1988, and 1987.

Ratemaking Investigation In 1986, the CPUC began an investigation to evaluate the effects of the Tax Reform Act of 1986 on ratemaking procedures. Revenue for recovery of income tax expense for 1987 and subsequent periods was collected subject to refund pending a CPUC decision.

In October 1988, Edison refunded approximately $51 million through the ERAM balancing account, in compliance with an August 1988 CPUC interim resolution. Final CPUC approval of the amounts refunded is pending. Because Edison had previously provided a reserve for this item, refunds to customers have not and are not expected to have any significant effect on net income.

New Accounting Standard Under accounting rules currently in effect, deferred income tax balances are not adjusted to reflect changes in tax law or rates. However, a new accounting standard will require such adjustments beginning in 1990.

The new standard requires significant balance sheet adjustments. The corporation will record additional deferred income taxes related to the equity component of AFUDC, which is currently recorded on an after-tax basis; the debt component of AFUDC, which was recorded on a net-of-tax basis prior to 1987; and other temporary differences for which deferred income taxes have not been provided.

Additional balance sheet adjustments will be recorded for the net reduction in deferred income tax liabilities resulting from income tax rate changes; the recognition of deferred income tax assets attributable to the reduction of the book basis of property by unamortized investment tax credits; and to classify property-related accumulated deferred taxes as a liability instead of a reduction of utility plant.

The majority of additional deferred-tax assets and liabilities will be offset by recording regulatory assets and liabilities representing the anticipated effect of these adjustments on customer rates. Such regulatory assets and liabilities will be adjusted as they are recovered or refunded through the ratemaking process and for changes in tax rates or laws.

Note 6. Employee Benefit Plans

Pension Plan SCEcorp has a trusteed noncontributory defined-benefit pension plan, covering substantially all full-time employees who fulfill minimum service requirements. Benefits are based on years of accredited service and average compensation. SCEcorp's policy is to fund the plan on a level premium actuarial method, provided that annual contributions meet the minimum funding requirements of the Employee Retirement Income Security Act and do not exceed the maximum deductible amount under income tax regulations. Prior service costs from pension plan amendments are funded over 30-year periods.

In 1987, a new accounting standard for defined-benefit plans was implemented that changed the basis used for determining pension expense. Before 1987, pension cost was based on the actuarial method used to determine annual contributions to the plan. For 1986, pension expense amounted to $48.6 million.

Pension expense under the new standard includes the following components:

In thousands	Year ended December 31, 1988	1987
Net pension expense:		
Service cost for benefits earned	$ 43,340	$ 46,629
Interest cost on projected benefit obligation	102,249	91,025
Actual return on plan assets	(133,687)	(130,723)
Net amortization and deferral	40,610	46,699
Pension liability pursuant to accounting standards	52,512	53,630
Regulatory adjustment	(6,416)	(3,481)
Net pension cost recognized	$ 46,096	$ 50,149

In conformity with the accounting principles for rate-regulated enterprises, regulatory adjustments have been recorded to reflect, in net income, the pension costs calculated under the actuarial method used for ratemaking purposes. The difference between pension costs calculated for accounting and ratemaking purposes has been recorded as a deferred charge on the consolidated balance sheets.

The plan's funded status is presented below:

In thousands	December 31, 1988	1987
Actuarial present value of benefit obligations:		
Vested benefits	$ 905,190	$ 800,952
Nonvested benefits	68,531	57,306
Accumulated benefit obligation	973,721	858,258
Value of projected future compensation levels	435,363	372,095
Projected benefit obligation	$1,409,084	$1,230,353
Plan assets at fair value	$1,326,635	$1,201,550
Benefit obligation in excess of plan assets	$ (82,449)	$ (28,803)
Unrecognized net gain	(49,021)	(101,562)
Unrecognized net obligation being amortized over 17 years	89,640	95,163
Accrued pension liability	$ (41,830)	$ (35,202)
Assumptions for defined benefit pension plan:		
Discount rate	8.0%	8.5%
Rate of increase in future compensation	6.0%	6.0%
Expected long-term rate of return on assets	8.5%	8.5%

Assets of the plan consist primarily of common stocks, corporate and government bonds, short-term investments, and guaranteed investment contracts.

Employee Stock Plans SCEcorp maintains an Employee Stock Ownership Plan (ESOP) and a Stock Savings Plus Plan (SSPP), which are designed to supplement employees' retirement income. Contributions to the ESOP were funded primarily by federal income tax benefits and contributions by employees. SCEcorp contributions to the SSPP were $16.9 million in 1988, $16.6 million in 1987, and $15.4 million in 1986.

Other Post-Employment Benefits Health care benefits and life insurance are provided for retired employees and their dependents. Group life insurance is provided through an insurance company. Health care is provided by a combination of SCEcorp facilities and insurance programs. The costs of these benefits for retirees were $22.8 million in 1988, $18.0 million in 1987, and $15.4 million in 1986.

Note 7. Jointly Owned Utility Projects

Edison owns undivided interests in several generating stations and transmission systems, for which each participant provides its own financing. The proportionate share of expenses pertaining to such projects is included in the appropriate operating expense category in the consolidated statements of income. The table below presents the investments in each project as included in the consolidated balance sheet as of December 31, 1988:

In thousands	Plant in Service	Accumulated Depreciation	Under Construction	Ownership Interest
El Dorado Transmission System	$ 21,649	$ 8,590	$ 108	60.00% (a)
Four Corners Coal Generating Station—Units 4 and 5	401,142	122,613	11,395	48.00
Mohave Coal Generating Station	233,708	95,919	877	56.00
Pacific Intertie DC Transmission System	115,047	34,075	69,550	50.00
Palo Verde Nuclear Generating Station	1,463,307	80,810	8,348	15.80
San Onofre Nuclear				
Generating Station:				
Unit 1	537,022	153,999	23,261	80.00
Units 2 and 3	2,759,741	477,523	18,084	75.05
Common facilities—Units 2 and 3	819,030	114,846	1,863	75.05
Common facilities—Units 1, 2 and 3	176,130	28,854	3,599	75.87
Yuma Axis Generating Station	12,369	10,516	69	33.30
Total	$6,539,145	$1,127,745	$137,154	

(a) Represents a composite rate.

Note 8. Leases

Investments in Leveraged Leases During 1987, a wholly owned, nonutility subsidiary became the lessor in several leveraged-lease agreements, under which its undivided interests in a nuclear power plant and a paper mill facility, having economic lives of 40 and 34 years, respectively, were leased for terms of 29 and 25 years, respectively. All operating, maintenance, and decommissioning costs are the responsibility of the lessees. The facilities' total cost was $609 million at December 31, 1988, and 1987.

The equity investment in these facilities represented 24% of the purchase price. The remaining 76% was nonrecourse debt, which is secured by first liens on the leased property. The lenders accept their security interests as their only remedy in the event of default by the lessee. The components of the net investment in leveraged leases are provided in the following table:

In thousands	December 31, 1988	1987
Rentals receivable (net of principal and interest on nonrecourse debt)	$243,999	$243,960
Less: Unearned income	95,972	115,102
Investment in leveraged leases	148,027	128,858
Current portion of rentals receivable	—	4,642
Less: Deferred income taxes	74,453	40,768
Net investment in leveraged leases	$ 73,574	$ 92,732

Operating Lease Commitments SCEcorp leases automotive, computer, office, and miscellaneous equipment through operating rental agreements with varying terms, provisions, and expiration dates. At December 31, 1988, estimated remaining rental commitments for noncancelable operating leases were as follows:

Year ended December 31,	*In thousands*
1989	$ 29,997
1990	26,088
1991	22,981
1992	19,112
1993	14,637
For periods therafter	16,266
Total future rental commitments	$129,081

On June 10, 1987, one of Edison's wholly owned subsidiaries purchased the leasing company from which Edison leased its nuclear fuel by assuming the company's commercial paper obligations. On March 1, 1988, Edison assumed the commercial paper obligations of the affiliated nuclear fuel lessor and terminated the nuclear fuel lease agreement. Lease liabilities supported by commercial paper borrowings, which had been classified as long-term obligations, have been reclassified as long-term debt to conform with the financial statement presentation of nuclear fuel financing on December 31, 1988. The long-term debt amount represents the estimated repayment of commercial paper based upon expected nuclear fuel consumption subsequent to one year after the balance sheet date and is supported by refinancing agreements with commercial banks.

Note 9. Commitments

Construction Program and Fuel Supply As of December 31, 1988, SCEcorp's construction expenditures are estimated to be $905 million for 1989, $712 million for 1990, and $713 million for 1991. In addition, minimum long-term commitments of approximately $1,607 million existed as of December 31, 1988, under fuel supply contracts.

Long-Term Purchased Power and Transmission Contracts Edison has contracted to purchase portions of the generating output of certain facilities and to purchase firm transmission service when appropriate. Although there is no investment in such facilities, these contracts provide for minimum payments based, in part, on the debt service requirements of the provider, whether or not the facility or transmission line is operable. None of these power contracts provide, or are expected to provide, more than 5% 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 consolidated statements of income. Purchased power costs are generally recoverable through the ECAC balancing account procedure. Selected information pertaining to these contracts on December 31, 1988, is summarized as follows:

	Purchased Power	Transmission Service
Years contracts expire	1990–2017	1990–2016
Share of effective operating capacity—megawatts	473.5–627.5	
Share of energy output	5.54%–100%	
Required minimum annual payments	*In thousands*	
1989	$ 46,468	$ 9,033
1990	13,854	6,030
1991	2,500	4,529
1992	2,500	4,422
1993	2,500	4,267
Thereafter	59,375	86,118
Total	$127,197	$114,399

Purchased power costs were $121.5 million in 1988, $118.0 million in 1987, and $115.3 million in 1986. Transmission costs were $11.4 million in 1988, $11.2 million in 1987, and $12.0 million in 1986.

Note 10. Contingencies

Nuclear Insurance On August 22, 1988, Congress amended the Price-Anderson Act, extending it until August 1, 2002. It increased—to $7.6 billion from $720 million—the limit on public liability claims that could arise from a nuclear incident. Participants in San Onofre and Palo Verde have purchased the maximum private primary insurance available, which currently is $200 million. The balance is to be covered by the industry's retrospective rating plan, using deferred premium charges. This secondary level of financial protection is required by the Nuclear Regulatory Commission (NRC). The maximum amount of the deferred premium that may be charged for each nuclear incident is $63 million per reactor, but not more than $10 million per reactor may be charged in any one year for each incident. Edison could be required to pay a maximum of $183.6 million per nuclear incident, on the basis of its ownership interests in San Onofre and Palo Verde, but it would have to pay no more than $29.1 million per incident in any one year. Such amounts include a 5% surcharge that would be applicable in the event that additional funds are needed to satisfy public liability claims, and are subject to adjustment for inflation.

Edison's property damage insurance covers losses up to $500 million at San Onofre and Palo Verde. Decontamination liability and property damage coverage in excess of the primary $500 million layer has also been purchased, exceeding NRC requirements. Insurance covering part of the additional expense of replacement power, which could result from an accident related nuclear unit outage, is also provided. After the first 21 weeks of such an outage, a maximum weekly indemnity of $2.7 million for a single unit for 52 weeks begins. An additional $1.4 million per week is provided for the next 52 weeks. These policies are issued primarily by 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, Edison could be assessed retrospective premium adjustments of up to $54.0 million per year. Insurance premiums are charged to operating expenses.

Antitrust Litigation In 1978, five resale customers filed a suit against Edison, in federal district court, alleging violation of antitrust laws. The complaint seeks monetary damages, a trebling of such damages, and certain injunctive relief. The complaint alleges that Edison engaged in anticompetitive behavior by charging more for electricity it sold to resale customers than it charged certain classes of retail customers. The complaint also alleges that Edison acted 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 Edison. The plaintiffs estimate that their actual damages, before trebling, were approximately $99.5 million from February 1, 1978, through December 31, 1985. The trial began on July 8, 1986, and concluded on September 26, 1986. Edison filed findings of fact and conclusions of law with the court on November 21, 1986. A decision is pending.

In 1983, another resale customer also filed suit, in federal district court, alleging violation of certain antitrust laws. The customer alleges that it has been denied access to lower-cost power and was overcharged for power purchases as well as other operational and financial damages. On July 17, 1988, Edison received the customer's antitrust damage study alleging total damages of approximately $135 million before trebling. A trial date of November 14, 1989, has been set.

The foregoing proceedings involve complex issues of law and fact. Although Edison is unable to predict the final outcome, it has categorically denied the resale customers' allegations.

Quarterly Financial Data

SCEcorp and Subsidiaries

Unaudited

In millions, except per share data	1988**					1987				
	Total	Fourth	Third	Second	First	Total	Fourth	Third	Second	First
Operating revenue	$6,253	$1,539	$2,029	$1,353	$1,332	$5,602	$1,414	$1,518	$1,354	$1,316
Operating income	1,096	196	476	228	196	965	233	258	249	225
Net income	762	107	392	146	117	739	171	212	187	169*
Per share:										
Earnings	3.49	.49	1.79	.67	.54	3.39	.78	.97	.86	.78*
Dividends declared	2.45½	.62	.62	.62	.59½	2.35½	.59½	.59½	.59½	.57
Common stock prices										
High	$34½	$34½	$33⅝	$34½	$34	$37	$33¾	$33⅜	$32⅝	$37
Low	$29⅛	$31¾	$30¾	$30	$29⅛	$27⅝	$27⅝	$29⅞	$28⅛	$31¾

Includes $68 million, or 31 cents per share, resulting from an accounting change. (See Note 2 of "Notes to Consolidated Financial Statements.")

***Quarterly fluctuations compared to 1987 are primarily the result of a December 1987 CPUC rate decision which ordered Edison to change the way it bills large customers, concentrating a larger percentage of these customers' annual charges into the summer months.*

Selected Financial Data 1984–1988

SCEcorp and Subsidiaries

In thousands, except percent, per share and ratio data	1988	1987	1986 (a)	1985	1984 (b)
SCEcorp					
Consolidated operating revenue	$6,252,719	$5,601,926	$5,368,087	$5,217,167	$4,899,152
Consolidated operating expenses	5,156,351	4,637,135	4,420,931	4,240,175	3,932,527
Consolidated net income	761,831	738,531	520,727	702,409	659,385
Weighted-average shares of common stock outstanding (000)	218,332	218,014	217,780	215,696	207,576
Per share data:					
Earnings	$3.49	$3.39	$2.39	$3.26	$3.18
Dividends declared	2.45½	2.35½	2.25	2.13	2.01
Book value (a)	23.18	22.16	21.13	21.04	19.89
Market value at year-end	32⅜	30½	33⅞	26⅝	22¾
Dividend payout ratio (paid basis)	69.6%	68.7%	92.9%	64.4%	61.9%
Rate of return on common equity (a)	15.33%	15.51%	11.09%	15.75%	16.28%
Price/earnings ratio	9.3	9.0	14.2	8.2	7.2
Ratio of earnings to fixed charges	2.86	2.91	2.71	2.97	2.70
Total assets (a)	$14,866,276	$14,350,664	$13,683,053	$13,256,054	$11,906,508
Common stock—paid-in capital	2,463,762	2,457,819	2,454,318	2,450,754	2,355,984
Retained earnings	2,601,086	2,375,915	2,150,751	2,128,646	1,886,804
Common shareholders' equity (a)	5,064,848	4,833,734	4,605,069	4,579,400	4,246,788
Preferred and preference stock of subsidiary					
—not subject to mandatory redemption	358,755	361,238	361,654	462,500	463,258
—subject to mandatory redemption	239,037	277,538	299,049	395,074	422,286
Long-term debt of subsidiaries	5,421,747	5,150,883	5,122,243	5,175,624	4,722,079
Southern California Edison Company					
Financial data:					
Earnings available for common stock	$684,689	$697,188	$503,198	$694,113	$655,917
Earnings per share (c)	3.14	3.20	2.31	3.22	3.16
Financial rate of return on common equity (a)	14.88%	15.32%	11.07%	15.93%	16.50%
Ratemaking rate of return on common equity—earned	12.20%	11.97%	12.42%	13.22%	14.24%
Ratemaking rate of return on common equity—authorized	12.75%	13.90%	14.60%	16.00%	16.00%
Internal generation of funds	100%	77%	74%	65%	67%
Operating and sales data:					
Area peak demand (MW)	15,987	14,775	14,599	14,587	15,189
Area generating capacity at peak (MW)	18,893	18,206	18,320	17,776	17,354
Kilowatt-hour sales (000)	67,885,761	65,539,481	64,197,405	64,984,566	63,310,047
Customers	3,831,656	3,717,262	3,589,414	3,490,325	3,400,182
Employees	16,660	17,086	17,553	17,182	16,844
The Mission Group					
Common shareholder's equity	$505,371	$292,108	$166,381	$134,310	$83,861
Net income	77,763	41,343	17,529	8,296	3,468
Earnings per share (c)	35¢	19¢	8¢	4¢	2¢
Percent of SCEcorp's earnings per share	10.0%	5.6%	3.3%	1.2%	0.6%

(a) Restated for nuclear plant construction-cost disallowances described in "Notes to Consolidated Financial Statements" on pages 35–36.
(b) Represents Edison's unconsolidated financial data, which would be substantially similar to SCEcorp's consolidated financial data.
(c) Based on weighted-average shares of SCEcorp common stock outstanding.

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

SCEcorp became the parent holding company of Southern California Edison Company (Edison) through a corporate reorganization approved by Edison shareholders during 1988. Unless stated otherwise, this discussion addresses the consolidated results of operations and financial condition of SCEcorp. SCEcorp is comprised of Edison and The Mission Group, the parent company for all subsidiaries not subject to rate regulation.

Results of Operations

Earnings Summary Earnings per share for 1988 increased 10 cents to $3.49 from $3.39 in 1987 despite a reduction by the California Public Utilities Commission (CPUC) in Edison's authorized rate of return on common equity from 13.9% to 12.75%. Net income rose 3.2% to a record $761.8 million and revenue to another record of $6.3 billion, compared to $5.6 billion in 1987. Factors contributing to the increased earnings include CPUC approval of 1988 expense levels that more accurately reflect Edison's costs, continued emphasis on cost containment, a CPUC award for favorable coal-plant operating performance, and higher earnings from The Mission Group.

The Mission Group's contribution to earnings per share for 1988 was 35 cents, or 10.0%, of total SCEcorp earnings, compared with 19 cents per share, or 5.6%, for 1987. The Mission Group's net income rose to $77.8 million from $41.3 million in 1987. Nonutility earnings per share increased by approximately 84% above those in 1987, with earnings growth in each nonutility business. Higher earnings resulted from the addition of 830 MW of new cogeneration and geothermal projects by Mission Energy Company, the sale of industrial property by Mission Land Company, increased construction contracting activity by Mission Power Engineering Company, and the first full year of operation for Mission First Financial.

Electric Operating Revenue and Sales Approximately 98% of electric operating revenue represents retail sales that are subject to rate regulation by the CPUC. The remaining revenue is from sales to wholesale customers, which are regulated by the Federal Energy Regulatory Commission (FERC).

Electric operating revenue increased by $430.6 million, or 7.8%, over last year, reflecting a 3.6% increase in kilowatt-hour sales. The increase in revenue is attributable to a 3.9% increase in retail sales volume that resulted from the addition of more than 114,000 new customers and the effect of rate changes. Resale sales volume declined 5.4% due to the availability of alternative energy sources to resale customers. Increases in electric operating revenue of 3.5% in 1987 and 2.6% in 1986 reflect, in addition to rate changes, a 5.1% retail sales volume increase in 1987 and a 1.2% sales volume decline in 1986.

Rate changes that became effective January 1, 1989, are projected to increase revenue by $77.7 million, or 1.3%. The CPUC approved an attrition increase of $116.4 million to recognize increases in nonfuel expenses and to increase Edison's authorized rate of return on common equity to 13.0% from 12.75%. In separate proceedings, the CPUC authorized a $77.1-million rate decrease after Edison completed full recovery of uranium contract settlement payments and granted a $38.4 million rate increase for additional plant investment in the San Onofre Nuclear Generating Station.

Investment and other operating revenue increased by $220.2 million, or 218.3%, reflecting growth in nonutility businesses. Continued increases in revenue from nonutility businesses are expected during 1989.

Operating Expenses Operating expenses for 1988 increased by $519.2 million, or 11.2%, over 1987, compared with increases of $216.2 million, or 4.9%, in 1987, and $180.8 million, or 4.3%, in 1986.

The net increase in operating expenses resulted primarily from utility operations. Fuel expense declined $119.0 million, or 10.9%, in 1988, compared with an increase of $226.6 million in 1987, and a decrease of $812.4 million in 1986. The reduction in fuel expense for 1988 is the result of increased nuclear generation which displaced higher cost natural gas generation. Additionally, the utility operated higher cost non-nuclear fuel-burning power plants less because of an increase in mandatory purchases of power from nonutility producers at CPUC-mandated rates that exceeded rates for economy purchases. Purchased power expense increased by $454.5 million, or 58.2%, over 1987. The effect on earnings of fuel and purchased power cost fluctuations is minimized by regulatory adjustment mechanisms established by the CPUC and the FERC.

Provisions for regulatory adjustment clauses for 1988 reflect net overcollections of $240.7 million. The overcollections are attributable to growth in kilowatt-hour sales; CPUC-authorized recovery of previously deferred energy costs through the Energy Cost Adjustment Clause; and amortization of deferred costs under an adjustment clause that was established to recover costs of major system additions.

Depreciation and decommissioning expense increased during 1988 by $95.2 million, of which $84.8 million is attributed to higher levels of decommissioning expense authorized by the CPUC. The remainder of the increase results from increased depreciation due to system growth.

Taxes on operating income for 1988 decreased $131.8 million, compared to 1987 resulting primarily from lower corporate tax rates instituted by the Tax Reform Act of 1986. However, the lower tax rates were offset by reduced electricity rates for customers and, therefore, had little or no effect on net income.

An increase in contracted nonutility engineering and construction services contributed approximately $138 million to the $183.0 million increase in other operating expenses for 1988. The remainder of the increase is principally due to Edison's system growth.

Other Income and Income Deductions Utilities capitalize an allowance for funds used during construction (AFUDC) which represents the cost of debt and equity capital used to finance construction of plant additions. Completion of the Balsam Meadow Hydro Project and Palo Verde Nuclear Generating Station (Palo Verde) Unit 3 contributed significantly to an $86.3 million decline in AFUDC compared to 1987. AFUDC has declined steadily over the past three years, as the construction of major projects has been completed and the facilities placed into service.

The $28.5 million increase in 1988 interest income over 1987, resulted from higher interest rates on invested cash, and increases in the average amounts of cash investments and regulatory-asset balances.

Significant Accounting Changes In accordance with changes in accounting standards for rate-regulated enterprises, in the first quarter of 1988 Edison recorded a noncash write-off against income of approximately $193 million, net of related income tax effects, for disallowed costs on its investment in nuclear facilities. As permitted by the new accounting standard, Edison adopted these changes by restating the financial results for 1986, the period in which the write-offs would have been recorded had the present accounting rules been in effect.

As discussed further in Note 5 of the "Notes to Consolidated Financial Statements," major balance sheet adjustments will be recorded in accordance with new income tax accounting requirements that become effective in 1990. These changes are not expected to significantly affect future earnings.

Financial Condition

Liquidity and Capital Resources SCEcorp's liquidity is affected primarily by construction expenditures and by capital requirements relating to debt and capital stock maturities. The capital resources available to meet these requirements include internal cash generation and external financings.

The majority of SCEcorp's capital requirements continue to be met by cash generated through operations. For 1988, nearly 80% of cash requirements were internally generated, compared with approximately 87% in 1987 and 96% in 1986. The decline in 1988 is attributed to an 18.4% reduction in cash from operations net of a 10.9% decrease in cash requirements. Cash flow and liquidity for 1988 were unfavorably affected by revenue deferred to future years under the Palo Verde Phase-in Plan, which will increase through 1990, and decline in subsequent years. Additional items impacting cash flow unfavorably are increased income tax payments resulting from the Tax Reform Act of 1986, and contributions of more than $157 million to nuclear decommissioning trusts related to 1988 and certain prior years. A decline in construction expenditures and the recovery of balancing account undercollections partially offset these adverse factors.

Through the issuance of long-term debt during 1988, SCEcorp raised $631.3 million of which Edison raised $622.7 million, primarily to finance the redemption of more costly debt, repay bond maturities, and to meet sinking fund requirements. Market conditions and other factors, including limitations imposed by Edison's Articles of Incorporation and Trust Indenture, influence external financings. As of December 31, 1988, Edison could issue approximately $3.8 billion of additional first and refunding mortgage bonds or approximately $1.7 billion of preferred stock at current interest and dividend rates under its Trust Indenture and Articles of Incorporation.

In conformity with CPUC-ratemaking procedures, short-term borrowings are utilized primarily to finance fuel-oil inventory, regulatory balancing account undercollections, and nuclear fuel. The principal and interest related to these special purpose short-term borrowings are recovered through regulatory balancing-account mechanisms. Note 4 of "Notes to Consolidated Financial Statements" discusses available lines of credit and related short-term borrowings.

Capital Requirements SCEcorp, on an unconsolidated basis, requires capital for common stock dividend payments, investment in nonutility subsidiaries and general and administrative expenses. These requirements are provided by dividend payments from Edison.

SCEcorp's primary capital requirements consist of expenditures under its subsidiaries' construction programs and debt and capital stock maturities. Such commitments are projected to total $4.9 billion from 1989 to 1993. It is anticipated that the majority of these capital requirements will be financed through internally generated cash with supplemental financing through the issuance of long-term debt.

Capital Structure The capital structure of SCEcorp as of December 31, 1988, is reflected in the table below:

Common equity	45.7%
Preferred stock	5.4
Long-term debt	48.9
Total	100.0%

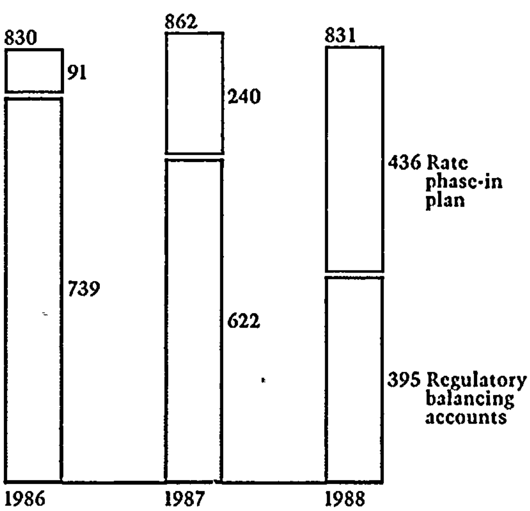
Proposed Merger

As discussed in Note 1 of "Notes to Consolidatd Financial Statements," on November 30, 1988, SCEcorp, Edison, and San Diego Gas & Electric Company (SDG&E) executed an agreement to merge SDG&E into Edison. Under the terms of the merger agreement, SCEcorp will exchange 1.3 shares of its newly issued common stock for each SDG&E common share. SDG&E preferred and preference stock will be exchanged for SCEcorp preferred and preference stock with similar provisions, except that dividends on each series will be increased between 2.5% and 20.0%.

The merger is subject to the approval of shareholders and various regulatory agencies, including the CPUC and the FERC. SCEcorp is working to complete the approval process in early 1990.

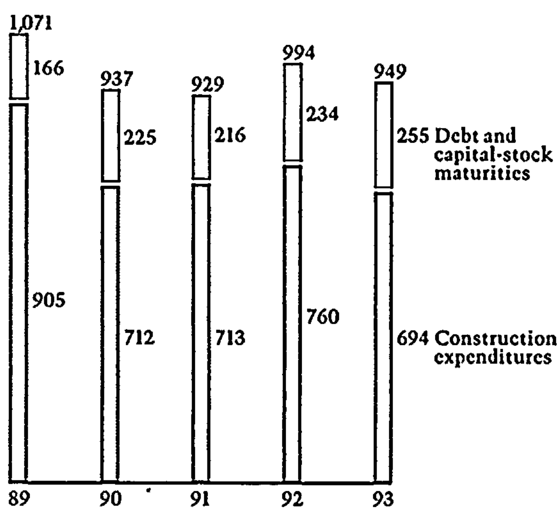
Balancing Accounts and
Rate Phase-in Plan (Utility)

In millions of dollars



Projected Capital
Requirements (SCEcorp)

In millions of dollars



First row (from left): Joan C. Hanley, Jack K. Horton, Howard P. Allen, William R. Gould, Camilla C. Frost.

Second row: Carl F. Huntsinger, Henry T. Segerstrom, Warren Christopher, Walter B. Gerken, Norman Barker, Jr., Edward Zapanta.

Third row: Charles D. Miller, Roy A. Anderson, Robert H. Smith, James M. Rosser, E. L. Shannon, Jr., J. J. Pinola.

Board of Directors

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

Roy A. Anderson
Chairman Emeritus
Lockheed Corporation
Burbank, California

Norman Barker, Jr.
Chairman of the Board
Pacific American Income Shares, Inc.
(A Closed-End Bond Fund)
Los Angeles, California

Warren Christopher
Chairman
O'Melveny & Myers
Los Angeles, California

Camilla C. Frost
Chairman of the Executive Committee
Los Angeles County Museum of Art
Los Angeles, California

Walter B. Gerken
Chairman of the Executive Committee
Pacific Mutual Life Insurance Company
Newport Beach, California

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

Joan C. Hanley
General Partner and Manager
Miramonte Vineyards
Temecula, California

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

Carl F. Huntsinger
General Partner
DAE Limited Partnership, Ltd.
(Agricultural Management)
Ojai, California

Charles D. Miller
Chairman of the Board and Chief Executive Officer
Avery International Corporation
(Manufacturer of Self-Adhesive Products)
Pasadena, California

J. J. Pinola
Chairman of the Board and Chief Executive Officer
First Interstate Bancorp
Los Angeles, California

James M. Rosser
President
California State University, Los Angeles
Los Angeles, California

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

E. L. Shannon, Jr.
President, Chief Executive Officer and Director
Santa Fe International Corporation
(Oil Service, Engineering, Petroleum Exploration
and Production)
Alhambra, California

Robert H. Smith
President and Chief Executive Officer
Security Pacific National Bank
and Vice Chairman of the Board
Security Pacific Corporation
Los Angeles, California

Edward Zapanta
Physician and Neurosurgeon
Monterey Park and East Los Angeles, California

* *Will not stand for re-election in 1989.*

Executive Officers

SCEcorp

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

David J. Fogarty
Executive Vice President

John E. Bryson
Executive Vice President
and Chief Financial Officer

Michael R. Peevey
Executive Vice President

Richard K. Bushey
Vice President and Controller

John R. Bury[1]
Vice President and General Counsel

David N. Barry III[2]
Vice President and General Counsel

Michael L. Noel
Vice President and Treasurer

Jennifer Moran
Secretary of the Corporation

(1) Mr. Bury retired effective March 1, 1989.
(2) Mr. Barry was elected Vice President and General Counsel effective March 1, 1989.

Southern California Edison Company

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

David J. Fogarty
Executive Vice President

John E. Bryson
Executive Vice President
and Chief Financial Officer

Michael R. Peevey
Executive Vice President

P. L. Martin
Senior Vice President

L. T. Papay
Senior Vice President

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

Glenn J. Bjorklund[1]
Vice President (Power Supply)

Robert H. Bridenbecker
Vice President (Customer Service)

John R. Bury[2]
Vice President and General Counsel

David N. Barry III[3]
Vice President and General Counsel

Richard K. Bushey
Vice President and Controller

Robert Dietch[4]
Vice President
(Engineering, Planning
and Research)

John R. Fielder[5]
Vice President (Information Services)

Charles B. McCarthy, Jr.
Vice President and Site Manager,
San Onofre Nuclear
Generating Station

Michael L. Noel
Vice President and Treasurer

Harold B. Ray
Vice President (Fuel and
Material Management)

Jennifer Moran
Secretary of the Corporation

(1) Effective January 1, 1989.
(2) Mr. Bury retired effective March 1, 1989.
(3) Mr. Barry was elected Vice President and General Counsel effective March 1, 1989.
(4) Mr. Dietch assumed additional responsibility for System Planning and Research effective January 1, 1989.
(5) Mr. Fielder was elected Vice President–Information Services effective January 1, 1989.

Nonutility Subsidiaries

H. Frederick Christie
President and Chief Executive Officer,
The Mission Group

J. Jack Adrian
President, Mission Power
Engineering Company

Thomas R. McDaniel
President, Mission First Financial

Edward A. Myers, Jr.[1]
President, Mission Energy Company

James S. Pignatelli[2]
President, Mission Energy Company

Robert E. Umbaugh
President, Mission Land Company

(1) Mr. Myers retired effective April 1, 1988.
(2) Effective April 1, 1988.

Corporate Offices:

SCEcorp
2244 Walnut Grove Avenue
Rosemead, California 91770
(818) 302-1297

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

The Mission Group
3010 Old Ranch Parkway
Seal Beach, California 90740
(213) 431-8488

Transfer Agent:

Southern California Edison Company maintains shareholder records and acts as transfer agent and registrar for SCEcorp common stock and Edison preferred stock.

Shareholder Services and Information:

Shareholder Services may be called at (800) 347-8625 between 8:00 a.m. and 4:30 p.m. Pacific Time every business day. The following may be handled by telephone:

- Stock transfer and name change requirements
- Address changes
- Replacement of dividend checks
- Duplicate 1099 forms and W-9 tax certification forms
- Notices of lost or destroyed stock certificates
- Duplicate dividend reinvestment statements and information regarding the plan.

Shareholders may also direct questions in writing to:

Shareholder Services
P.O. Box 400
Rosemead, California 91770

Investor Relations:

Security analysts, investment professionals or other organizations may contact:

Manager of Investor Relations
P.O. Box 999
Rosemead, California 91770
(818) 302-2515

Stock Listing:

SCEcorp common shares are listed and traded on the New York, Pacific, London and Tokyo stock exchanges under the trading symbol SCE. Most Edison preferred shares are listed on the American and Pacific stock exchanges under the same symbol.

Newspaper Listing:

SCEcorp's symbol is SCEcp and Southern California Edison preferred stock's symbol is SoCalEd.

Dividend Reinvestment:

SCEcorp's Dividend Reinvestment and Stock Purchase Plan permits the automatic reinvestment of dividends and voluntary cash investments. For information, contact Shareholder Services.

Annual Meeting:

The annual shareholders' meeting will be at 10 a.m., Thursday, April 20, 1989, at the Industry Hills and Sheraton Resort, One Industry Hills Parkway, City of Industry, California.

1988 ANNUAL REPORT

ARIZONA PUBLIC SERVICE COMPANY

APS

APS DIRECTORS

Joe Acosta, 65, Robert C. Acosta, P.C. (certified public accountants), Phoenix, Arizona

Dino DeConcini, 55, attorney at law, Phoenix, Arizona

[1] O. Mark De Michele, 55, president and chief executive officer of the Company, Phoenix, Arizona

[1] Karl Eller, 60, chairman of the board, The Circle K Corporation, Phoenix, Arizona

Marianne Moody Jennings, 35, professor of business law, College of Business Administration, Arizona Sate University, Tempe, Arizona.

Jack M. Morgan, 65, attorney at law, Farmington, New Mexico

Marvin R. Morrison, 65, farmer, cattle feeder and dairyman, Morrison Brothers Ranch, Higley, Arizona

Jaron B. Norberg, 51, executive vice president and chief financial officer of the Company, Phoenix, Arizona

[1] John R. Norton III, 60, chairman and chief executive officer, J. R. Norton Company (agricultural production), Phoenix, Arizona

Donald M. Riley, 45, president and general manager, Gilpin's Enterprises, Inc. (general contractor), Yuma, Arizona

Wilma W. Schwada, 62, civic leader and homemaker, Tempe, Arizona

Verne D. Seidel, 63, managing partner of HMS Properties (property management), Flagstaff, Arizona

[1] Richard Snell, 58, chairman of the board, president and chief executive officer, Ramada Inc., Phoenix, Arizona

[1] Keith L. Turley, 65, chairman of the board of the Company; chairman of the board, president and chief executive officer of Pinnacle West Capital Corporation, Phoenix, Arizona

[1] Morrison F. Warren, 65, professor emeritus of education, Arizona State University, Tempe, Arizona

[1] Ben F. Williams, Jr., 59, mayor of the City of Douglas and attorney at law, Douglas, Arizona

Thomas G. Woods, Jr., 62, consultant to the Company; formerly executive vice president of the Company for the Arizona Nuclear Power Project (retired February 1985), Phoenix, Arizona

(Age on Annual Meeting date, April 18, 1989)

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[1] Member of the Executive Committee.

INDEPENDENT AUDITORS' REPORT

Arizona Public Service Company:

We have audited the accompanying balance sheets of Arizona Public Service Company as of December 31, 1988 and 1987 and the related statements of income, retained earnings and cash flows for each of the three years in the period ended December 31, 1988. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company at December 31, 1988 and 1987 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1988 in conformity with generally accepted accounting principles.

As discussed in Note 1 to the financial statements, in 1987 the Company changed its method of accounting for unbilled revenues.

Deloitte Haskins & Sells

Phoenix, Arizona
February 21, 1989

12. Supplementary Income Statement Information.

Other taxes charged to operations during each of the three years in the period ended December 31, 1988 are as follows:

	Year Ended December 31,		
	1988	1987	1986
	(Thousands of Dollars)		
Ad valorem	$ 79,730	$ 71,357	$ 55,798
Sales	69,107	62,783	58,606
Other	11,860	10,214	9,189
Total other taxes	$160,697	$144,354	$123,593

13. Selected Quarterly Financial Data (Unaudited).

Quarter	Operating Revenues (a)	Operating Income	Net Income	Earnings for Common Stock
	(Thousands of Dollars)			
1988				
First	$313,389	$ 83,142	$ 57,168	$ 48,719
Second	336,723	92,333	57,294	48,936
Third	469,092	157,827	125,466	117,177
Fourth	322,819	69,778	31,283	23,060
1987				
First	$291,020	$ 65,171	$ 74,320(b)	$65,109(b)
Second	329,665	81,122	75,185	67,267
Third	394,498	108,539	101,453	94,068
Fourth	307,747	72,532	62,915	54,479

(a) Operating revenues for 1987 and for the first three quarters of 1988 have been restated to conform to year-end 1988 presentation.

(b) Includes cumulative effect as of January 1, 1987 of accruing unbilled revenues, net of income taxes, of $16,110,000.

	1988	1987
Principal actuarial assumptions used were:		
Discount rate	9.0%	9.0%
Rate of increase in compensation levels	6.5%	6.5%
Expected long-term rate of return on assets	10.44%	10.15%

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for active and retired employees. Life insurance benefits are provided through an insurance company whereas health care costs are paid as expenses are incurred under a self-insured plan. The cost of providing those benefits for both active and retired employees amounted to approximately $21,991,000, $22,721,000, and $18,591,000, of which approximately $8,564,000, $8,922,000, and $6,285,000 were charged to expense in 1988, 1987 and 1986, respectively. Remaining amounts were either capitalized as a component of construction costs or billed to participants of jointly-owned facilities. The cost of providing such benefits solely to retired employees is not significant.

11. Commitments and Contingencies.

Nuclear Insurance

The Palo Verde participants have insurance for public liability payments resulting from nuclear energy hazards to the full limit of liability under federal law. This potential liability is covered by primary liability insurance provided by commercial insurance carriers in the amount of $200 million and the balance by an industrywide retrospective assessment program. The maximum assessment per reactor under the retrospective rating program for each nuclear incident is approximately $66 million, subject to an annual limit of $10 million per incident. Based upon the Company's 29.1% interest in the three Palo Verde units, the Company's maximum potential assessment per incident is approximately $58 million, with an annual payment limitation of $8.73 million. The insureds under this liability insurance include the Palo Verde participants and "any other person or organization with respect to his legal responsibility for damage caused by the nuclear energy hazard."

The Palo Verde participants maintain "all risk" (including nuclear hazards) insurance for nuclear property damage to, and decontamination of, property at Palo Verde in the aggregate amount of $1.725 billion, a substantial portion of which must first be applied to decontamination. The Company has also secured insurance against portions of any increased cost of generation or purchased power resulting from the accidental outage of any of the three units if the outage exceeds 21 weeks.

Litigation

The Company is a party to various claims, legal actions and complaints arising in the ordinary course of business, including a lawsuit seeking to invalidate the Company's contract with various municipalities for the purchase of effluent to be used as cooling water for Palo Verde. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the operations or financial position of the Company.

Purchase Commitments

The Company has significant purchase commitments in connection with its continuing construction program. Construction expenditures in 1989 have been estimated at $280 million.

The new statement will be effective beginning in 1990, although earlier adoption is encouraged. SFAS No. 96 will be implemented by recording a cumulative effect adjustment as of the beginning of the year in which the new standard is first adopted. The Company expects adoption of SFAS No. 96 to have little impact on earnings and has not yet made a determination as to the timing of implementation.

10. Pension Plan and Other Benefits.

The Company's pension plan, a defined benefit plan, covers virtually all employees. The benefits are based on years of service and compensation utilizing the final average pay plan benefit formula. It is the Company's policy to fund the plan on a current basis to the extent deductible under existing tax regulations. Pension cost, including administrative cost, for 1988, 1987, and 1986 was approximately $4,368,000, $1,484,000, and $2,751,000, respectively, of which approximately $1,899,000, $601,000, and $602,000, respectively was charged to expense; the remainder was either capitalized as a component of construction costs or billed to participants of jointly-owned facilities. Plan assets consist primarily of common stocks, U.S. obligations and bonds.

Net periodic pension cost (income) included the following (thousands of dollars):

	1988	1987
Service cost-benefits earned during the period	$ 12,589	$ 12,580
Interest cost on projected benefit obligation	22,945	20,095
Return on plan assets	(48,832)	(17,634)
Net amortization and deferral	15,547	(15,790)
Net periodic pension cost (income)	$ 2,249	$ (749)

The following table sets forth the plan's funded status and amounts recognized in the Company's Balance Sheets (thousands of dollars):

	1988	1987
Actuarial present value of benefit obligation, including vested benefits of $148,824 and $137,857	$178,019	$165,869
Effect of projected future compensation increases	92,202	79,852
Projected benefit obligation	270,221	245,721
Plan assets, at fair value	333,840	299,073
Plan assets in excess of projected benefit obligation	63,619	53,352
Unrecognized net (gain) loss from past experience different from that assumed	(21,686)	989
Unrecognized prior service cost	7,135	90
Unrecognized net asset at January 1, 1986 being recognized over 20.2 years	(55,325)	(58,541)
Accrued pension liability included in other deferred credits	$ (6,257)	$ (4,110)

9. Income Tax Expense.

The components of income tax expense for each of the three years in the period ended December 31, 1988 are as follows:

	Year Ended December 31, 1988	1987	1986
	(Thousands of Dollars)		
Currently payable:			
Federal	$ 63,457	$ 50,073	$ 46,463
State	12,254	3,428	17,951
Other	—	235	1,643
Total current	75,711	53,736	66,057
Deferred:			
Depreciation—net	72,709	86,128	62,347
Palo Verde cost deferral	49,178	45,279	18,989
Taxes, pension costs and other—net	(4,594)	13,995	65,561
Sale of utility plant	—	—	(84,697)
Investment tax credit—net	(9,107)	(1,824)	28,563
Total deferred	108,186	143,578	90,763
Total	$183,897	$197,314	$156,820

The difference between income tax expense and the amount obtained by multiplying income before income taxes by the statutory federal income tax rate for each of the three years in the period ended December 31, 1988 are as follows:

	Year Ended December 31, 1988	1987	1986
	(Thousands of Dollars)		
Federal income tax expense at statutory rate (34% in 1988, 40% in 1987 and 46% in 1986)	$154,737	$204,475	$198,232
Increases (reductions) in tax expense resulting from:			
Tax under book depreciation	22,316	30,935	18,855
Allowance for funds used during construction	(4,103)	(27,430)	(60,711)
Palo Verde cost deferral	(4,815)	(20,965)	(11,505)
Investment tax credit amortization	(8,287)	(8,273)	(5,975)
State income tax—net of federal income tax benefit	23,429	18,481	13,239
Other	620	91	4,685
Total provision for federal and state income tax expense	$183,897	$197,314	$156,820

In December 1987, the FASB issued SFAS No. 96, "Accounting for Income Taxes." SFAS No. 96 retains the concept of comprehensive interperiod tax allocation; however, the way in which deferred income taxes are computed has changed from the existing "deferred" method to a liability concept. Adjustments to balances of accumulated deferred income taxes will have to be made to record income tax rate changes, allowance for funds used during construction, investment tax credits and other temporary differences not previously deferred. It is expected that the additional deferred income tax assets and liabilities will be offset primarily by regulatory assets and liabilities representing the expected future revenue requirement impact of these adjustments.

7. Jointly-Owned Facilities.

At December 31, 1988, the Company-owned interests in jointly-owned electric generating and transmission facilities are as follows (dollars in thousands):

	Percent owned by Company	Plant in Service	Accumulated Depreciation	Net Plant in Service	Construction Work in Progress
Generating Facilities:					
Palo Verde Nuclear Generating Station - Units 1, 2 and 3	(a)	$2,433,167	$148,677	$2,284,490	$12,265
Four Corners Steam Generating Plant - Units 4 and 5	15.0%	128,705	30,624	98,081	4,264
Navajo Steam Generating Plant - Units 1, 2 and 3	14.0%	126,731	49,959	76,772	336
Transmission Facilities:					
ANPP 500KV Transmission System .	35.8%(b)	61,681	5,585	56,096	277
Navajo Southern Transmission System .	31.4%(c)	27,449	11,590	15,859	150
Palo Verde-Yuma 500KV System	23.9%(d)	15,531	1,935	13,596	165
Total		$2,793,264	$248,370	$2,544,894	$17,457

(a) The Company owns 29.1% of Units 1 and 3 and approximately 17% of Unit 2 (see Note 8).

(b) Weighted average of interests varying from 34.6% to 43.95%.

(c) Weighted average of interests varying from 14% to 100%.

(d) Weighted average of interests varying from 11% to 100%.

The foregoing dollar amounts correlate to the Company's percentage interest in each facility. The Company's share of related operating and maintenance expenses is included in Operating Expenses.

8. Leases.

In 1986, the Company entered into sale and leaseback transactions under which it sold approximately 42% of its 29.1% share of Palo Verde Unit 2 resulting in net proceeds of $487,296,000. The resulting gain of approximately $140,220,000 has been deferred and is being amortized to operations expense over the original lease term. The leases require semi-annual payments of approximately $22,061,000 through December 1996, $23,605,000 through June 1997 and $26,963,000 through December 2015, and include options to renew the leases for two additional years and to purchase the property at fair market value at the end of the lease terms. The leases are being accounted for as operating leases. Lease expense for 1988, 1987 and 1986 amounted to $45,458,000, $43,445,000 and $9,985,000, respectively, of which $10,312,000, $39,421,000 and $9,060,000 were deferred as allowed by an order from the ACC. Lease expense for 1988 was deferred until April 1, 1988 when Unit 2 rates became effective (see Note 2).

6. Lines of Credit.

The Company's lines of credit at December 31, 1988 and 1987 are summarized below. No amounts were outstanding under the lines at December 31, 1988 and 1987.

	1988	1987
	(Thousands of Dollars)	
Commercial paper backup lines	$200,000	$200,000
Other bank lines	102,000	226,000
Total	$302,000	$426,000

The commitment fees for the commercial paper backup lines and virtually all of the other bank lines (exclusive of the credit agreement referred to below) were 3/16% per annum in 1988 and 3/8% per annum in 1987. As of December 31, 1987, other bank lines included $200,000,000 available under a credit agreement between the Company and various banks which carried a commitment fee of 1/4% per annum.

By statute the Company's short-term borrowings cannot exceed 7% of total capitalization without the consent of the ACC.

irrevocable letter of credit issued by a bank. These bonds bear interest at such rate, determined weekly, as will cause the bonds to have a market value which approximates, as nearly as possible, their par value.

(c) On May 15, 1985 the Company borrowed from a governmental authority the proceeds of a $55,200,000 issue of adjustable-rate annual tender pollution control revenue refunding bonds for the purpose of refunding $55,200,000 in aggregate principal amount of previously issued pollution control bonds due April 1, 1986. The new issue is supported by a long-term irrevocable letter of credit issued by a bank. The bonds bear an interest rate, determined annually, which will cause the bonds to have a market value which approximates, as nearly as possible, their par value.

(d) Represented pollution control funds deposited with a revenue bond trustee which were disbursed as needed to pay the costs of acquiring, constructing, reconstructing, improving, maintaining, equipping or furnishing the facilities financed.

(e) Represents domestic commercial paper and borrowings under a $120,000,000 Eurocommercial paper program agreement among the company and various financial institutions that is supported by a revolving credit agreement which expires in 1991. At December 31, 1988, the outstanding balance consisted of $89,500,000 of Eurocommercial paper and $30,500,000 of domestic commercial paper. At December 31, 1987, the outstanding balance consisted of $86,000,000 of Eurocommercial paper and $34,000,000 of domestic commercial paper. Commercial paper interest rates are negotiated at the time of borrowing. Interest rates applicable to borrowings under the revolving credit agreement are LIBOR plus 0.30% to 0.45%, with commitment fees of 0.15% on the unused credit line.

(f) Represents the present value of future lease payments (discounted at the interest rate of 7.48%) on a combined cycle plant sold and leased back from the independent owner-trustee formed to own the facility. The lease requires semi-annual payments of $2,582,000 through June 2001, and includes renewal and purchase options based on fair market value. This plant is included in plant in service at its original cost of $54,405,000; accumulated depreciation at December 31, 1988 was $28,155,000.

Aggregate annual payments due on long-term debt and for sinking fund requirements through 1993 are as follows: 1989, $37,985,000; 1990, $98,193,000; 1991, $173,365,000; 1992, $143,551,000; and 1993, $34,551,000. See Note 4 for sinking fund requirements and redemptions of redeemable preferred stock.

Substantially all utility plant (other than nuclear fuel, transportation equipment and the combined cycle plant mentioned above) is subject to the lien of the first mortgage bonds. The indenture respecting the first mortgage bonds includes provisions which would restrict the payment of dividends on common stock under certain conditions which did not exist at December 31, 1988.

5. Long-Term Debt.

Details of long-term debt outstanding at December 31, 1988 and 1987 are as follows:

	December 31, 1988	December 31, 1987
	(Thousands of Dollars)	
First Mortgage Bonds:		
Maturing through 1993:		
4.7% due March 1, 1989	$ 20,000	$ 20,000
4.8% due November 1, 1991	35,000	35,000
4.45% due June 1, 1992	25,000	25,000
4.40% due December 1, 1992	25,000	25,000
4.5% due September 1, 1993	15,000	15,000
Maturing 1994 through 1998 - 6.25% to 12%	500,000	500,000
Maturing 1999 through 2003 - 7.45% to 12.875%	221,979	249,645
Maturing 2004 through 2008 - 6% to 13.25%	252,000	252,000
Maturing 2015 through 2017 - 9% to 11.5%	450,000	450,000
Unamortized discount and premium	(4,402)	(4,598)
Total first mortgage bonds	1,539,577	1,567,047
Pollution Control Indebtedness:		
Maturing August 1, 2009 (a)	106,980	106,980
Maturing December 1, 2009 (b)	147,000	147,000
Maturing May 1, 2013 (b)	65,750	65,750
Maturing May 1, 2014 (c)	55,200	55,200
Maturing February 1, 2015 (a)	49,400	49,400
Less securities held by trustee (d)	—	(11,104)
Total pollution control indebtedness	424,330	413,226
12.5% guaranteed debentures due February 15, 1992	75,000	75,000
Revolving credit agreements (e)	120,000	120,000
Term loan due June 1990 (LIBOR plus ¼%)	80,000	80,000
Capitalized lease obligation (f)	41,458	43,410
Other	552	1,063
Total long-term debt	2,280,917	2,299,746
Less current maturities:		
4.7% first mortgage bonds due March 1, 1989	20,000	—
Sinking fund requirements on first mortgage bonds	15,333	15,333
Capitalized lease obligation (f)	2,100	1,952
Other	552	511
Total current maturities	37,985	17,796
Total long-term debt less current maturities	$2,242,932	$2,281,950

(a) Adjustable-rate annual tender pollution control revenue refunding bonds supported by a long-term irrevocable letter of credit issued by a bank. The bonds bear an interest rate, determined annually, which will cause the bonds to have a market value which approximates, as nearly as possible, their par value.

(b) Consisting of borrowings from a governmental authority which has funded that amount through issuance of a series of par value demand bonds supported by a long-term

Redeemable preferred stock transactions during each of the three years in the period ended December 31, 1988 are as follows (dollars in thousands):

Description	Number of Shares	Par Value Amount
Balance, December 31, 1985	2,194,211	$219,421
Retirements:		
$10.00 Series H	(16,000)	(1,600)
$10.70 Series I	(209,934)	(20,993)
$9.70 Series L	(96,000)	(9,600)
$11.95 Series M	(85,000)	(8,500)
Balance, December 31, 1986	1,787,277	178,728
Issuances:		
$8.48 Series S	500,000	50,000
$8.50 Series T	500,000	50,000
Retirements:		
$10.00 Series H	(16,000)	(1,600)
$8.80 Series K	(67,500)	(6,750)
$9.70 Series L	(384,000)	(38,400)
$12.50 Series P	(100,000)	(10,000)
Balance, December 31, 1987	2,219,777	221,978
Retirements:		
$10.00 Series H	(16,000)	(1,600)
$8.80 Series K	(22,500)	(2,250)
$9.70 Series N	(51,800)	(5,180)
Balance, December 31, 1988	2,129,477	$212,948

(c) Redeemable at $105.04 through September 1, 1989, and thereafter declining by $0.36 per year to par after September 1, 2002. Applicable sinking fund provisions require the redemption of 16,000 shares at par annually (representing annual payments of $1,600,000).

(d) Redeemable at $106.00 through February 28, 1989; at $103.00 through February 28, 1994; and at $101.00 thereafter. Applicable sinking fund provisions require the redemption of 22,500 shares at par annually (representing annual payments of $2,250,000). The Company may, but is not required to, redeem an additional 22,500 shares at par on March 1 in any year.

(e) Redeemable after June 1, 1992 at the option of the Company at $106.11 through June 1, 1993, declining by $0.68 per year to $100.00 after June 1, 2001. Applicable sinking fund provisions require the redemption at par value between 1988 and 2002 of all shares according to a predetermined schedule.

(f) Redeemable after June 1, 1994 at the option of the Company at $105.45, declining each year by a predetermined amount to $100.00 after June 1, 2004. Applicable sinking fund provisions require the redemption at par value between 1990 and 2004 of all shares according to a predetermined schedule.

(g) Not redeemable prior to June 1, 1992 with the proceeds of borrowed funds or stock issues having a lower cost of money than this Series' dividend rate. Otherwise, redeemable at the option of the Company at $108.48 per share prior to June 1, 1992, at $104.24 prior to June 1, 1993, at $102.12 prior to June 1, 1994 and at $100.00 per share thereafter. Applicable sinking fund provisions require the redemption at par of 100,000 shares annually beginning June 1, 1993.

(h) All outstanding shares to be redeemed at par on September 1, 1994.

If there were to be any arrearage in dividends on any of its preferred stock or in the sinking fund requirements applicable to any of its redeemable preferred stock (each such dividend being cumulative and of equal ranking with other such dividends, and each such requirement being cumulative and of equal ranking with other such requirements), the Company could not pay dividends on its common stock or acquire any shares thereof for consideration. If any such dividend arrearage were to equal six or more quarterly dividends, the holders of preferred stock, in addition to their other voting rights and voting by the classes prescribed for this purpose, could elect a total of six directors (all series of serial preferred stock, regardless of par value and whether redeemable or non-redeemable, comprising one such class and being entitled to elect two of the six directors). See Note 3 in regard to other voting rights of holders of preferred stock.

The combined aggregate amount of redemption requirements for the above issues each year through 1993 are as follows: $6,440,000 in 1989; $9,873,000 in 1990; $9,873,000 in 1991; $9,141,000 in 1992; and $18,273,000 in 1993.

The holders of preferred stock are entitled to one vote for each share held of record. Special requirements for favorable votes of holders of preferred stock, voting by the classes respectively prescribed for the several purposes, pertain to (i) certain conversions or exchanges of outstanding preferred stock, (ii) the authorization of any stock ranking prior to the preferred stock, (iii) making any change in the terms and provisions of preferred stock that would adversely affect the rights and preferences of the holders thereof, (iv) the issuance of any additional shares of preferred stock except under prescribed circumstances or (v) a merger, consolidation or sale of substantially all the assets of the Company. The foregoing voting rights attach to both redeemable and non-redeemable preferred stock, as do the rights that would arise out of dividend arrearages as discussed in Note 4.

Changes in common and non-redeemable preferred stock and premiums and expenses during each of the three years in the period ended December 31, 1988 are as follows (dollars in thousands):

Description	Common Stock		Non-redeemable Preferred Stock (cumulative)		Premiums and Expenses Net*
	Number of Shares	Par Value Amount	Number of Shares	Par Value Amount	
Balance, December 31, 1985	71,264,947	$178,162	4,374,199	$218,561	$1,040,909
Premiums and Expenses - Net	—	—	—	—	(825)
Balance, December 31, 1986	71,264,947	178,162	4,374,199	218,561	1,040,084
$3.58 Series O	—	—	(2,000,000)	(50,000)	—
Premiums and Expenses - Net	—	—	—	—	(5,720)
Balance, December 31, 1987	71,264,947	178,162	2,374,199	168,561	1,034,364
Premium and Expenses - Net	—	—	—	—	(106)
Balance, December 31, 1988	71,264,947	$178,162	2,374,199	$168,561	$1,034,258

*Premiums and expenses — net also includes those of redeemable preferred stock issues (see Note 4).

4. Redeemable Preferred Stock.

The balances at December 31, 1988 and 1987 of preferred stock which is redeemable at the option of the holders or pursuant to sinking fund obligations, in addition to being callable by the Company, are as follows:

	Number of Shares Outstanding at December 31,		Par Value			Call Price Per Share(a)
	1988	1987	Per Share	Outstanding at December 31, 1988	Outstanding at December 31, 1987	
				(Thousands of Dollars)		
Redeemable Preferred Stock (cumulative)						
Serial preferred: (b)						
$10.00 Series H	56,677	72,677	$100.00	$ 5,668	$ 7,268	(c)
$8.80 Series K	254,600	277,100	100.00	25,460	27,710	(d)
$12.90 Series N	318,200	370,000	100.00	31,820	37,000	(e)
$11.50 Series R	500,000	500,000	100.00	50,000	50,000	(f)
$8.48 Series S	500,000	500,000	100.00	50,000	50,000	(g)
$8.50 Series T	500,000	500,000	100.00	50,000	50,000	(h)
Total	2,129,477	2,219,777		$212,948	$221,978	

(a) In each case plus accrued dividends.

(b) See Note 3 for authorized number of shares.

A specific rate application designed for recovery of Unit 3 costs has not yet been filed with the ACC. However, the Company intends to file such a rate application and an application for an extension of the deferral period prior to June 30, 1989.

Financial Accounting Standards

In October 1987, the Financial Accounting Standards Board ("FASB") issued SFAS No. 92, "Regulated Enterprises—Accounting for Phase-in Plans," which precludes the Company from recording an equity return on cost deferrals. The Company has not been able to accrue an equity return for Unit 3, which adversely affected net income by approximately $2 million per month in 1988 as compared to 1987.

Effective January 1, 1988, SFAS No. 90, "Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs," requires any disallowance, direct or indirect, of the cost of a recently completed plant to be recognized as a loss.

3. Common and Non-redeemable Preferred Stock.

The balances at December 31, 1988 and 1987 of common stock and of preferred stock, which is not redeemable except pursuant to call by the Company at its option, are as follows.

	Number of Shares			Par Value			Call Price Per Share(a)
	Authorized	Outstanding at December 31, 1988	Outstanding at December 31, 1987	Per Share	Outstanding at December 31, 1988 (Thousands of Dollars)	Outstanding at December 31, 1987 (Thousands of Dollars)	
Common Stock	100,000,000	71,264,947	71,264,947	$ 2.50	$178,162	$178,162	—
Non-redeemable Preferred Stock (cumulative):							
$1.10 preferred	160,000	155,945	155,945	$ 25.00	$ 3,898	$ 3,898	$ 27.50
$2.50 preferred	105,000	103,254	103,254	50.00	5,163	5,163	51.00
$2.36 preferred	120,000	40,000	40,000	50.00	2,000	2,000	51.00
$4.35 preferred	150,000	75,000	75,000	100.00	7,500	7,500	102.00
Serial preferred	1,000,000						
$2.40 Series A		240,000	240,000	50.00	12,000	12,000	50.50
$2.625 Series C		240,000	240,000	50.00	12,000	12,000	51.00
$2.275 Series D		200,000	200,000	50.00	10,000	10,000	50.50
$3.25 Series E		320,000	320,000	50.00	16,000	16,000	51.00
Serial preferred	4,000,000(b)						
$8.32 Series J		500,000	500,000	100.00	50,000	50,000	(c)
Adjustable rate Series Q		500,000	500,000	100.00	50,000	50,000	(d)
Serial preferred	10,000,000	—	—	25.00	—	—	
Total		2,374,199	2,374,199		$168,561	$168,561	

(a) In each case plus accrued dividends.

(b) This authorization also covers outstanding redeemable preferred shares shown in Note 4, as well as the non-redeemable shares indicated above.

(c) At $103.00 through August 31, 1992; and at $101.00 thereafter.

(d) Bears dividends at a rate, adjusted on a quarterly basis, 2% below the rate borne by certain United States Treasury securities, but in no event less than 6% per annum or greater than 12% per annum. Redeemable at the option of the Company at $103.00 through February 28, 1993; and at $100.00 thereafter.

Pursuant to the Nuclear Waste Policy Act of 1982 ("Act"), contracts have been entered into with the U.S. Department of Energy for disposal of spent nuclear fuel. The Act provides for an assessment of $0.001 per kilowatt-hour of nuclear generation. This amount is charged to nuclear fuel expense and recovered through the Company's fuel adjustment clauses.

2. ACC and Related Matters.

Prudence Audit

On September 4, 1986, the ACC issued an order establishing the format for a prudence audit of Palo Verde costs. Ernst & Whinney, a national accounting firm, is overseeing the prudence audit, a report on which is expected sometime in 1989. Pursuant to the order, the Company submitted for review ten areas in which it believes its performance in the construction of Palo Verde exceeds the prudence audit standard of "reasonableness." A procedural framework has not been established within which the ACC would formally consider the reasonableness of Palo Verde costs. Any Palo Verde costs disallowed by the ACC for inclusion in the Company's rates (whether as a result of the prudence audit or otherwise) will be recognized as a loss by the Company at such time as it becomes probable that the costs will be disallowed for ratemaking purposes. Although the Company is unable to predict the ultimate outcome of this matter, management believes that overall, Palo Verde was planned and constructed in a prudent manner.

Pursuant to an order issued by the ACC in April 1988, the Company estimates that up to $124 million of revenues collected through December 31, 1988 are to be deemed interim or temporary pending the outcome of the prudence audit. In the opinion of management, the amount, if any, of such revenues to be refunded will not be material to the Company's financial statements.

Construction Limit

As an incentive to complete construction and commence operation of Palo Verde, in November 1984, the ACC issued an order that set a construction cost limit of $2.86 billion for the Company's share of Palo Verde. Amounts expended in excess of the construction cost limit are presumed to be imprudently incurred for ratemaking purposes (although no presumption of prudence will attach to expenditures made up to such limit). Management believes that the Company's share of Palo Verde construction costs will not exceed the limit when the costs are finalized.

Palo Verde Unit 2

On April 1, 1988, the ACC issued an order in the rate case in which the Company requested an increase in annual retail electric rates to recover the costs of Unit 2 and other increased costs of service. The new rates (including recovery of costs deferred and decommissioning costs) became effective April 1, 1988; however, as previously discussed, rates attributable to the inclusion of portions of Unit 1 and Unit 2 costs in the Company's rate base are to be deemed interim or temporary pending the outcome of the prudence audit.

Palo Verde Unit 3

On April 6, 1988, the ACC issued an accounting and ratemaking order that allows the Company, for ACC purposes, to defer and capitalize substantially all Unit 3 operating costs (excluding fuel) and to accrue a carrying charge on its ownership interest in Unit 3 and one-third of the facilities common to all three Palo Verde units. The ACC ordered the period for accumulating such deferrals to commence on January 8, 1988 and to terminate on December 31, 1989, unless the Company files an application for an extension of the deferral period with the ACC at least six months prior to December 31, 1989. Unit 3 cost deferrals amounted to approximately $123 million before income taxes at December 31, 1988.

January 1, 1987 of the change, net of income taxes, is $16.1 million and is reported as a separate component of 1987 net income. The pro forma effect of this change on the reported earnings of the prior period presented is not significant.

Retail rate schedules include adjustment clauses which permit recovery of costs of certain fuel and purchased power. Regulatory hearings are held periodically to adjust the rates applicable under fuel adjustment clauses to more nearly match actual fuel costs. Temporary net under or over-recoveries of costs resulting from application of the adjustment clauses are recognized as a deferred fuel asset or liability, respectively, with an offsetting amount recognized in purchased power and interchange expense.

f. Allowance for funds used during construction—In accordance with the regulatory accounting practice prescribed by the FERC and the ACC, the Company capitalizes an allowance for the cost of funds used to finance its construction program ("AFC"). AFC, which does not represent current cash earnings, is defined as the cost of borrowed funds and a reasonable rate of return on equity funds used during construction. The calculated amount is capitalized as a part of the cost of utility plant.

AFC has been calculated using composite rates of 12.75% from January 1986 through October 1986; 11.25% for November and December 1986; 11.20% for 1987; and 11.25% thereafter. The Company compounds AFC semi-annually and ceases to accrue AFC when construction is completed and the property is placed in service.

g. Income taxes—The Company uses accelerated depreciation methods for income tax purposes. As prescribed by the ACC, deferred income taxes are provided for certain timing differences arising from the recording, for income tax and financial reporting purposes, of depreciation of property placed in service after January 1, 1977. In accordance with an ACC order, the Company defers amounts equal to the change in income taxes arising from substantially all other timing differences, which prior to October 1983 were reflected currently in income. At December 31, 1988 the Company had flowed through to income currently approximately $205 million of income tax benefits arising from income tax timing differences for which deferred taxes have not been provided.

In compliance with an ACC order, the Company defers amounts equal to the reduction in Federal income taxes arising from investment tax credits and amortizes these amounts to other income over the estimated life of the related assets.

In 1981, the Company sold to another corporation certain federal income tax benefits in exchange for cash. The Company, pursuant to an order of the ACC, has recorded the proceeds of the sale as a deferred credit and is amortizing the amount of such proceeds on a straight-line basis over approximately 30 years.

The Company is included in the consolidated income tax returns of Pinnacle West. Income taxes are allocated to the Company based on its separate company income or loss. Income taxes paid to Pinnacle West amounted to $67,575,000 and $93,156,000 in 1988 and 1987, respectively.

h. Research and development costs—The Company expenses research and development costs on a current basis, except that costs which may result in additions to utility plant are deferred for subsequent inclusion in plant or to be written off if the applicable project is abandoned.

i. Reacquired debt costs—In accordance with the regulatory accounting practices prescribed by the ACC, the Company defers the excess of the reacquisition price of reacquired debt over the net carrying amount and amortizes these amounts to expense over the remainder of the original life of the issues reacquired.

j. Nuclear fuel—Nuclear fuel is charged to fuel expense using the unit of production method under which the number of units of thermal energy produced in the current period is related to the total thermal units expected to be produced over the remaining life of the fuel.

ARIZONA PUBLIC SERVICE COMPANY
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies.

a. System of accounts—The accounting records of Arizona Public Service Company (the "Company") are maintained in accordance with the uniform system of accounts prescribed by the Federal Energy Regulatory Commission ("FERC").

b. Consolidation—All the shares of common stock of the Company are owned by Pinnacle West Capital Corporation ("Pinnacle West"). The financial statements for 1986 and 1987 were consolidated and included the accounts of the Company and those of its wholly-owned subsidiaries. All significant intercompany balances and transactions were eliminated. As of December 31, 1988 the Company had dissolved these subsidiaries and assumed their assets and liabilities. As a result, the financial statements for 1988 are not consolidated. The financial impact of these dissolutions was not significant and the financial statements are comparable for the periods shown. Certain prior year items have been reclassified to conform to 1988 presentation.

c. Statements of Cash Flows—The Company has adopted Statement of Financial Accounting Standards ("SFAS") No. 95, "Statement of Cash Flows," in 1988, and has conformed its 1987 and 1986 financial statements to include statements of cash flows. For purposes of the statements of cash flows, the Company considers all temporary cash investments and marketable securities to be cash equivalents. Temporary cash investments and marketable securities have maturities or put dates of three months or less.

d. Plant and depreciation—Property is stated at original cost as defined for regulatory purposes. The cost of additions to utility plant and replacements of retirement units is capitalized. Replacements of minor items of property are charged to expense as incurred. In addition to direct costs, capitalized items include the present value of certain future lease payments (see Note 5), research and development expenditures pertaining to construction projects, indirect charges for engineering, supervision, transportation and similar costs, and an allowance for funds used during construction. Costs of depreciable units of plant retired are eliminated from plant accounts and such costs plus removal expenses less salvage are charged to accumulated depreciation. Contributions in aid of construction are credited to plant cost.

Depreciation on utility property is provided on a straight-line basis at rates authorized by the Arizona Corporation Commission (the "ACC") annually. The applicable rates for 1986 through 1988 ranged from 0.68% to 9.86%.

Decommissioning costs for the Palo Verde Nuclear Generating Station ("Palo Verde") are recovered through rates and charged to depreciation expense. Total decommissioning costs for all three Palo Verde units are estimated at approximately $615 million (in 1986 dollars) of which the Company's share (29.1%) is approximately $179 million.

Decommissioning expense recovered in retail rates is being deposited in external trust funds until the decommissioning of nuclear facilities takes place. At December 31, 1988 $4,349,000 had been deposited in the external trust funds and is included in the Company's Investments and Other Assets.

e. Revenues and fuel costs—Effective January 1, 1987, the Company changed its method of recording revenues. Prior to that date, the Company recorded revenues as billed to its customers on a monthly cycle billing basis. The unbilled revenue for those kilowatt hours delivered to customers after meter reading dates became part of operating revenues in the following month. In order to better match revenues with expenses, the Company changed its method of accounting to accrue an estimate of revenue for sales unbilled at the end of each month. This change also serves to conform the Company's accounting treatment with the treatment of unbilled revenues as taxable under the Tax Reform Act of 1986. The cumulative effect as of

ARIZONA PUBLIC SERVICE COMPANY

STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1988	1987	1986
	(Thousands of Dollars)		
Cash Flows from Operations:			
Income before cumulative effect of accounting change	$ 271,211	$ 297,763	$ 274,120
Items not requiring cash:			
Depreciation and amortization	194,334	160,298	139,541
Nuclear fuel amortization	51,165	31,722	21,762
Allowance for equity funds used during construction	(12,069)	(59,015)	(93,734)
Deferred income taxes — net	118,606	131,009	62,420
Deferred investment tax credit — net	(9,107)	(1,824)	28,563
Deferred fuel	(58)	57,595	50,341
Palo Verde cost deferral	(146,911)	(156,250)	(63,788)
Changes in certain current assets and liabilities:			
Accounts receivable — net	8,644	(6,990)	16,915
Utility revenues accrued	(6,029)	(34,995)	—
Materials, supplies and fossil fuel	(8,605)	1,650	(23,331)
Other current assets	3,842	161,462	(168,057)
Accounts payable	(7,836)	13,735	(1,711)
Taxes accrued	10,851	(27,729)	38,816
Interest accrued	1,278	(336)	(20,180)
Other current liabilities	(133)	(12,819)	19,318
Other — net	18,187	13,102	6,817
Total	487,370	568,378	287,812
Cumulative effect of accounting change	—	16,110	—
Net cash provided	487,370	584,488	287,812
Cash Flows from Financing:			
Preferred stock	—	99,562	—
Long-term debt	11,668	383,318	521,738
Short-term borrowings — net	49,500	(37,000)	19,000
Dividends paid on common stock	(210,944)	(205,242)	(209,968)
Dividends paid on preferred stock	(33,003)	(33,136)	(39,738)
Repayment of preferred stock	(9,030)	(106,750)	(40,693)
Repayment and reacquisition of long-term debt	(31,406)	(328,156)	(537,114)
Net cash used	(223,215)	(227,404)	(286,775)
Cash Flows from Investing:			
Capital expenditures	(277,228)	(403,488)	(568,056)
Allowance for equity funds used during construction	12,069	59,015	96,810
Palo Verde Unit 2 sale and leaseback	—	—	487,296
Other	(4,763)	(5,738)	(18,188)
Net cash used	(269,922)	(350,211)	(2,138)
Net increase (decrease) in cash and marketable securities	(5,767)	6,873	(1,101)
Cash and marketable securities at beginning of period	13,643	6,770	7,871
Cash and marketable securities at end of period	$ 7,876	$ 13,643	$ 6,770
Supplemental Disclosure of Cash Flow Information:			
Cash paid during the year for:			
Interest (excluding capitalized interest)	$ 193,289	$ 156,760	$ 164,672
Income taxes	$ 67,575	$ 93,156	$ 26,390

See Notes to Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY

STATEMENTS OF RETAINED EARNINGS

	Year Ended December 31,		
	1988	1987	1986
	(Thousands of Dollars)		
Retained earnings at beginning of year	$693,051	$617,370	$592,334
Add—Net income	271,211	313,873	274,120
Total	964,262	931,243	866,454
Deduct—Dividends:			
Common stock (Notes 3, 4 and 5)	210,944	205,242	209,805
Preferred stock (see below)	33,319	32,950	39,279
Total	244,263	238,192	249,084
Retained earnings at end of year	$719,999	$693,051	$617,370
Dividends on preferred stock:			
$1.10 preferred	$ 172	$ 172	$ 172
$2.50 preferred	258	258	258
$2.36 preferred	94	94	94
$4.35 preferred	326	326	326
Serial preferred:			
$2.40 Series A	576	576	576
$2.625 Series C	630	630	630
$2.275 Series D	455	455	455
$3.25 Series E	1,040	1,040	1,040
$10.00 Series H	674	833	994
$10.70 Series I	—	—	942
$8.32 Series J	4,160	4,160	4,160
$8.80 Series K	2,372	2,686	3,033
$9.70 Series L	—	858	3,880
$11.95 Series M	—	—	426
$12.90 Series N	4,561	4,835	4,773
$3.58 Series O	—	2,983	7,160
Adjustable Rate Series P	—	315	1,250
Adjustable Rate Series Q	3,538	3,263	3,360
$11.50 Series R	5,973	5,824	5,750
$8.48 Series S	4,240	2,544	—
$8.50 Series T	4,250	1,098	—
Total	$ 33,319	$ 32,950	$ 39,279

See Notes to Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY

BALANCE SHEETS

LIABILITIES

	December 31, 1988	December 31, 1987
	(Thousands of Dollars)	
Capitalization (Notes 3, 4 and 5):		
Common stock	$ 178,162	$ 178,162
Premiums and expenses—net	1,034,258	1,034,364
Retained earnings	719,999	693,051
Common stock equity	1,932,419	1,905,577
Nonredeemable preferred stock	168,561	168,561
Redeemable preferred stock	212,948	221,978
Long-term debt less current maturities	2,242,932	2,281,950
Total Capitalization	4,556,860	4,578,066
Current Liabilities:		
Notes payable to banks	15,000	—
Commercial paper	34,500	—
Current maturities of long-term debt (Note 5)	37,985	17,796
Accounts payable	74,127	76,612
Accrued taxes	74,914	64,063
Accrued interest	53,440	52,162
Deferred fuel	33,543	33,601
Other	35,509	35,326
Total Current Liabilities	359,018	279,560
Deferred Credits and Other:		
Deferred income taxes	650,739	521,797
Deferred investment tax credit	192,135	201,242
Unamortized gain—sale of utility plant (Note 8)	126,120	131,659
Unamortized credit related to sale of tax benefits	38,583	40,270
Customers' advances for construction	26,044	26,077
Other	41,465	39,917
Total Deferred Credits and Other	1,075,086	960,962
Commitments and Contingencies (Notes 2 and 11)		
Total	$5,990,964	$5,818,588

ARIZONA PUBLIC SERVICE COMPANY

BALANCE SHEETS

ASSETS

	December 31, 1988	December 31, 1987
	(Thousands of Dollars)	
Utility Plant (Notes 5, 7 and 8):		
Electric plant in service and held for future use	$6,008,411	$4,993,363
Less accumulated depreciation and amortization	1,218,699	1,088,356
Total	4,789,712	3,905,007
Construction work in progress	251,223	1,154,829
Nuclear fuel, net of amortization of $83,308,000 and $48,055,000	71,713	33,199
Utility Plant—net	5,112,648	5,093,035
Investments and Other Assets (at cost)	51,198	46,430
Current Assets:		
Cash and marketable securities	7,876	13,643
Accounts receivable:		
Service customers	87,839	84,781
Other	22,985	34,365
Allowance for doubtful accounts	(2,840)	(2,518)
Accrued utility revenues (Note 1)	41,024	34,995
Materials and supplies (at average cost)	79,686	66,766
Fossil fuel (at average cost)	25,278	26,873
Other	9,968	13,810
Total Current Assets	271,816	272,715
Deferred Debits:		
Deferred income taxes	121,724	111,388
Palo Verde cost deferral (Note 2)	361,042	219,689
Unamortized costs of reacquired debt	25,996	29,301
Unamortized debt issue costs	16,570	17,643
Other	29,975	28,387
Total Deferred Debits	555,307	406,408
Total	$5,990,964	$5,818,588

See Notes to Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY

STATEMENTS OF INCOME

	Year Ended December 31,		
	1988	1987	1986
	(Thousands of Dollars)		
Electric Operating Revenues	$ 1,442,023	$ 1,322,930	$ 1,255,057
Fuel Expenses:			
Fuel for electric generation	207,387	180,597	178,814
Purchased power	33,592	44,773	54,891
Deferred fuel	(4)	55,154	57,320
Total	240,975	280,524	291,025
Operating Revenues Less Fuel Expenses	1,201,048	1,042,406	964,032
Other Operating Expenses:			
Operations excluding fuel expenses	244,913	213,510	157,196
Maintenance	108,153	102,319	98,032
Depreciation and amortization	194,334	160,298	139,541
Income taxes (Note 9)	157,350	178,850	182,316
Other taxes (Note 12)	160,697	144,354	123,593
Palo Verde cost deferral (Note 2)	(67,479)	(84,289)	(25,526)
Total	797,968	715,042	675,152
Operating Income	403,080	327,364	288,880
Other Income (Deductions):			
Allowance for equity funds used during construction	12,069	59,015	93,734
Palo Verde cost deferral (Note 2)	79,432	71,961	38,262
Income taxes (Note 9)	(26,547)	(6,004)	25,496
Other - net	6,740	1,484	16,355
Total	71,694	126,456	173,847
Income Before Interest Deductions	474,774	453,820	462,727
Interest Deductions:			
Interest on long-term debt	202,173	190,587	214,029
Interest on short-term borrowings	4,988	5,122	6,973
Debt discount, premium and expense	6,251	6,781	5,851
Allowance for borrowed funds used during construction	(9,849)	(46,433)	(38,246)
Total	203,563	156,057	188,607
Income Before Cumulative Effect of Accounting Change	271,211	297,763	274,120
Cumulative Effect as of January 1, 1987 of Accruing Unbilled Revenues, Net of Income Taxes of $12,460,000 (Note 1)	—	16,110	—
Net Income	271,211	313,873	274,120
Preferred Stock Dividend Requirements	33,319	32,950	39,279
Earnings for Common Stock	$ 237,892	$ 280,923	$ 234,841

See Notes to Financial Statements.

In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes." The Company will adopt the new standard in 1989 or 1990 and expects it to have little impact on earnings. See Note 9 of Notes to Financial Statements.

Net income reflects accounting practices unique to regulated public utilities and represents a composite of cash and non-cash items, including AFC and the cost deferrals associated with Palo Verde Units 2 and 3 (see Statements of Cash Flows).

Effects of Inflation

In contrast to the analysis of increases in operating revenues in the table at the beginning of "Operating Results," it is sometimes difficult, in the case of operation and maintenance expenses, to distinguish between effects of volume increases and rises in unit costs.

Certain inflationary effects, such as those on costs of generating fuel, are passed through to customers pursuant to rate adjustment procedures currently in effect (see "Liquidity and Capital Resources" above). Nevertheless, the Company attempts to minimize such effects by means that include increasing the availability of its nuclear and coal-fired units to result in a more economical fuel mix. This increase has been achieved by an intensive maintenance program, the cost of which is not covered by the adjustment clauses. There are a number of other major expense items that are also beyond the scope of the adjustment clauses. Inflationary pressures on these items have given rise to a significant earnings attrition between general rate increases.

seasonal rates on annual average revenue per kilowatt-hour. The year-to-year changes in non-energy related electric revenues reflect changes in the revenues collected for the capacity sold to other utilities.

Fuel expenses increased in 1988 and 1987 as increased system energy requirements more than offset lower unit fuel costs resulting from increased nuclear generation attributable to Palo Verde Units 2 and 3.

Variations in purchased power expense reflect contractual commitments with other utilities for purchasing power as a means of augmenting the Company's own generating sources from time to time. The decrease in purchased power from 1986 to 1988 was primarily due to decreased purchases as a result of increased nuclear generation.

Nearly all of the Company's fuel costs are either recovered currently or deferred pursuant to the PPFAM and, accordingly, do not materially affect earnings. Recovery or refund of such deferred amounts is subject to an ACC review and approval process which requires a hearing. See "Liquidity and Capital Resources" for further discussion.

Palo Verde Unit 2 commenced commercial operation on September 19, 1986. The Company began expensing the costs of operating and maintaining Unit 2 and ceased accruing an allowance for funds used during construction ("AFC") on such investment at that time. Pursuant to an ACC accounting and ratemaking order, the Company deferred Unit 2 operating costs (excluding fuel) and accrued a carrying charge on such deferrals until April 1, 1988, the effective date of new rates to cover the costs relating to Unit 2. As a result, earnings were not significantly affected by the increased costs and reduced AFC. In accordance with Statement of Financial Accounting Standards No. 92, "Regulated Enterprises — Accounting for Phase-In Plans," ("SFAS No. 92") between January 1, 1988 and April 1, 1988, the Company did not accrue, for financial reporting purposes, an equity return on Unit 2 cost deferrals, the net income effect of which was approximately $8 million.

Palo Verde Unit 3 commenced commercial operation on January 8, 1988. The Company began expensing the costs of operating and maintaining Unit 3 and ceased accruing AFC on such investment at that time. On April 6, 1988, the ACC issued an accounting and ratemaking order that allows the Company, for ACC purposes, to defer and capitalize substantially all Unit 3 operating costs (excluding fuel) and to accrue a carrying charge on its ownership interest in Unit 3 and one-third of the facilities common to all three Palo Verde units. The ACC ordered the period for accumulating such deferrals to commence on January 8, 1988 and to terminate on December 31, 1989, unless the Company files an application for an extension of the deferral period with the ACC at least six months prior to December 31, 1989, in which case the accounting and ratemaking order will continue in effect after December 31, 1989, at least until the ACC rules on the application for an extension. A specific rate application designed for recovery of Unit 3 costs has not yet been filed with the ACC. However, the Company intends to file such a rate application and an application for an extension of the deferral period prior to June 30, 1989. Although the ACC is allowing the Company to accrue a carrying charge on Unit 3, SFAS No. 92, as previously discussed, precludes the accrual of an equity return on Unit 3 cost deferrals, which adversely affected net income by about $2 million per month in 1988 as compared to 1987.

Effective January 1, 1987, the Company changed its method of recording revenues to include revenue related to electricity delivered to customers but not yet billed at year-end. The cumulative effect, as of January 1, 1987, of the change, net of income taxes, was $16.1 million and is reported as a separate component of 1987 net income. See Note 1e of Notes to Financial Statements for further discussion.

general rate order is granted by the ACC. The Company will also pursue additional wholesale or interchange sales opportunities to offset the estimated loss of $20 million in revenues in 1989 resulting from the partial expiration of the agreement.

Operating Results

Net income decreased in 1988 to $271,211,000 compared to $313,873,000 and $274,120,000 in 1987 and 1986, respectively. The largest single factor in the decline in 1988 earnings as compared to 1987 was the Company not accruing an equity return on Palo Verde Unit 2 and Unit 3 cost deferrals pursuant to SFAS No. 92 (as described below). Another significant factor was the change in method of accounting for revenues which resulted in a one-time earnings increase in January 1987. Also contributing to the earnings decline in 1988 was the Company's allowed rate of return on equity being reduced from 14.0% to 12.5% effective April 1, 1988 in the Palo Verde Unit 2 rate decision. The above impacts were somewhat offset by the net income effect of increased revenues, which were largely due to customer growth and increased sales per customer in 1988.

The earnings increase in 1987 as compared to 1986 is primarily attributable to the change in method of accounting for revenues as discussed previously, decreased interest costs and the earnings impact of increased revenues arising principally from colder weather conditions in the winter months of 1987. The following paragraphs discuss these issues in more detail.

Total operating revenues include the effects of rate increases and adjustment clauses on prices of units sold. Operating revenues also reflect volume changes in unit sales. The foregoing factors contributed to annual increases (decreases) in electric operating revenues over the preceding calendar year as follows:

	Year Ended December 31,		
	1988	1987	1986
	(Thousands of Dollars)		
Energy related:			
Volume increases (decreases) (1)	$ 88,021	$ 89,942	$(1,334)
Revenue per kilowatt-hour increases (decreases) (2)	32,879	(19,694)	53,657
Non-energy related:			
Revenue increases (decreases) (3)	(1,807)	(2,375)	18,950
Total increase	$119,093	$ 67,873	$71,273

(1) Calculated by summing the results of multiplying the year-to-year increases in units sold in each customer class by the weighted average of the applicable rate levels in effect for the prior year.

(2) Calculated by summing the results of multiplying the year-to-year increases in the weighted average of rate levels in each customer class times the applicable number of units sold in the current year.

(3) Includes revenues for miscellaneous services and transmission for others.

In 1988, the volume-related increases occurred in the residential, business and resale customer classes. The increases were largely due to customer growth, increased sales per customer as a result of warmer summer weather, increased sales to copper mines and increased sales for resale. In 1987, the volume-related increase in electric revenues was primarily due to increased customers and sales per customer in the residential and commercial classes. The increase in residential sales per customer was largely due to colder weather conditions in the winter months of 1987. In 1986, the volume-related decrease was largely due to lower sales to resale customers. Price-related revenue increases and decreases reflect the timing and amounts of base rate changes, the operation of the Company's PPFAM, the incentive for customers to migrate over time to that rate which produces the lowest bill, and the effect of weather and

Palo Verde Rate Matters

On September 4, 1986, the ACC issued an order establishing the format for a prudence audit of Palo Verde costs. Ernst & Whinney, a national accounting firm, is overseeing the prudence audit, a report on which is expected in the near future. Pursuant to the order, the Company submitted for review ten areas in which it believes its performance in the construction of Palo Verde exceeds the prudence audit standard of "reasonableness." A procedural framework has not been established within which the ACC would formally consider the reasonableness of Palo Verde costs. Any Palo Verde costs disallowed by the ACC for inclusion in the Company's rates (whether as a result of the prudence audit or otherwise) will be recognized as a loss by the Company at such time as it becomes probable that the costs will be disallowed for ratemaking purposes. Although the Company is unable to predict the ultimate outcome of this matter, management believes that, overall, Palo Verde was planned and constructed in a prudent manner.

Pursuant to an order issued by the ACC in April 1988, the Company estimates that up to $124 million of revenues collected through December 31, 1988 related to Palo Verde Units 1 and 2 are to be deemed interim or temporary pending the outcome of the prudence audit. In the opinion of management, the amount, if any, of such revenues to be refunded will not be material to the Company's financial statements.

In November 1984, the ACC issued an order that set a construction cost limit of $2.86 billion for the Company's share of Palo Verde, with any amounts expended above that figure to be presumed as imprudently incurred for ratemaking purposes (although no presumption of prudence will attach to expenditures made up to such limit). Management believes that the Company's share of Palo Verde construction costs will not exceed the limit when the costs are finalized.

See "Operating Results" for a discussion of ACC matters regarding Palo Verde Unit 3.

Purchased Power and Fuel Adjustment Mechanism

The Company's purchased power and fuel adjustment mechanism ("PPFAM") provides for the recovery of the Company's actual generating fuel and purchased power expenses from its retail customers. The PPFAM can result in under- or over-recovered balances as a result of variations in the level of fuel and purchased power expenses. Over-recovered balances, which are anticipated to be returned by the Company over time to retail customers through operation of the PPFAM, account for the $33.5 million and $33.6 million "Deferred fuel" liability in the Company's Balance Sheets as of December 31, 1988 and 1987, respectively.

The Company is currently operating under a format that requires an annual ACC hearing to review the Company's experienced and projected under- or over-recoveries of fuel and purchased power costs from retail customers through prevailing rates. The latest hearing was completed in January 1989. Although the ACC staff recommended the immediate elimination of the PPFAM, the Company recommended that the PPFAM continue or, in the alternative, that deferred fuel accounting be adopted, with any under- or over-recoveries to be addressed in the next request by the Company to the ACC for a change in retail electric rates. A decision in this hearing is expected sometime in 1989. If the ACC eliminates the PPFAM, the Company would request recovery of any changes in such fuel and purchased power costs in a general rate request.

Other

The Company is currently operating under an agreement with Southern California Edison Company ("SCE") whereby approximately 350 megawatts of capacity is sold from Unit 4 of the Cholla Power Plant. A portion of this agreement (44%) expires on June 1, 1989 with the remainder expiring as of June 1, 1990. The Company plans to seek an accounting order deferring the Cholla 4 costs that will no longer be recovered by the SCE agreement until a

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Liquidity and Capital Resources

The Company has capital requirements for its ongoing construction program, currently estimated to be $280 million for 1989, and for the refunding or redemption of maturing securities (see Notes 3, 4 and 5 in Notes to Financial Statements). In 1988, the Company financed approximately 81% of its capital expenditures with internally generated funds after the payment of dividends and should be able to finance approximately two-thirds of its capital expenditures internally in the period 1989 through 1991. This situation may deteriorate, however, if the Company does not receive adequate rate relief for the recovery or deferral of costs of Unit 3 of the Palo Verde Nuclear Generating Station ("Palo Verde") (see "Operating Results" for further discussion). The Company has a degree of flexibility in adjusting its construction program to its financing capability; however, that flexibility is somewhat limited and its long-term liquidity will depend on its access to the capital markets, which in turn will depend on sufficiency of rates to provide adequate coverages on its senior securities and an adequate rate of return on common stock equity. Adequate earnings and coverages are critical to the maintenance of satisfactory credit ratings on the Company's senior securities and, as calculated in accordance with the governing instruments, are prerequisite to the Company's legal ability to issue such securities.

Provisions in the Company's mortgage bond indenture and articles of incorporation restrict it from issuing additional first mortgage bonds or preferred stock, respectively, unless its earnings (as defined) cover by at least the prescribed number of times the amount of interest (as to bonds) and the amount of interest plus preferred stock dividend requirements (as to preferred stock) on the securities to be outstanding after completion of the new issue. Further, the indenture limits the amount of additional bonds which could be issued to a percentage of net "property additions" and property previously pledged as security for certain bonds heretofore redeemed or retired. As of December 31, 1988, management estimates that the applicable documents would have allowed the issuance of either $1.1 billion of additional first mortgage bonds, on the basis of net property additions (as compared to approximately $2.0 billion on the basis of coverages), or $596 million of preferred stock.

See page 5 with respect to the Company's capitalization at December 31, 1988. If interest and dividend rates on new issues of long-term debt and preferred stock rise in the future, the Company's average cost of capital will rise accordingly. During 1986 the Company entered into sale and leaseback transactions under which it sold and leased back approximately 42% of its 29.1% ownership interest in Palo Verde Unit 2. The leases are accounted for as operating leases and, accordingly, are not reflected in the Company's capitalization (see Note 8 of Notes to Financial Statements).

By statute, the Company's short-term borrowings may not exceed 7% of its total capitalization without the consent of the Arizona Corporation Commission (the "ACC"). Such borrowings are an important source of funds, particularly between permanent financings, and the statute could limit the Company's financing flexibility from time to time. However, the Company's own general policy relating to short-term borrowings is consistent with that of the statute.

The ACC has regulatory authority over the Company in matters relating to retail electric rates and the issuance of securities. Accordingly, the Company's liquidity and operating results may be significantly affected by the outcome of the following pending or anticipated ACC matters referred to throughout this discussion.

OTHER FINANCIAL AND OPERATING STATISTICS

	1988	1987	1986	1985	1984
		(Dollars in Thousands, Except Per Hour Amounts)			
Capitalization:					
Common equity	$ 1,932,419	$ 1,905,577	$ 1,835,616	$ 1,811,405	$ 1,695,923
Non-redeemable preferred stock	168,561	168,561	218,561	218,561	218,561
Redeemable preferred stock	212,948	221,978	178,728	219,421	282,740
Long-term debt	2,242,932	2,281,950	1,928,491	2,205,940	1,684,746
Total	$ 4,556,860	$ 4,578,066	$ 4,161,396	$ 4,455,327	$ 3,881,970
Utility plant—gross ...	$ 6,414,655	$ 6,229,446	$ 5,880,435	$ 5,712,507	$ 5,088,243
Utility plant—net	$ 5,112,648	$ 5,093,035	$ 4,904,325	$ 4,873,823	$ 4,344,083
Number of employees at year-end	8,135	8,926	8,966	8,324	7,358
Average wage per hour	$ 17.02	$ 16.09	$ 15.23	$ 14.48	$ 13.61
Electric resources (kw)	4,311,800	3,925,600	3,592,100	3,570,800	3,425,900
Peak load (kw)	3,371,600	3,159,300	3,194,600	3,197,800	2,970,600
Electric sales—total (mwh)*	17,760,896	15,404,312	14,180,458	14,348,204	14,133,513
Number of customers at year-end	582,003	566,384	545,018	521,567	499,751

OPERATING REVENUES

	1988	1987	1986	1985	1984
			(Thousands of Dollars)		
Electric					
Residential	$ 545,082	$ 505,525	$ 466,816	$ 438,265	$ 378,536
Commercial	501,666	467,643	441,236	401,439	343,971
Industrial	166,346	146,925	141,729	135,254	126,187
Irrigation	14,989	16,641	21,547	22,853	25,540
Other*	114,180	88,630	85,816	107,010	116,971
Total*	1,342,263	1,225,364	1,157,144	1,104,821	991,205
Transmission for others	17,187	14,254	19,692	16,602	13,023
Miscellaneous services	82,573	83,312	78,221	62,361	21,316
Total operating revenues*	$ 1,442,023	$ 1,322,930	$ 1,255,057	$ 1,183,784	$ 1,025,544

* Certain prior year items have been reclassified to conform to 1988 presentation.

ARIZONA PUBLIC SERVICE COMPANY

SELECTED FINANCIAL DATA

	1988	1987	1986	1985	1984
	(Dollars in Thousands, Except Per Share Amounts)				
Electric Operating Revenues*	$ 1,442,023	$ 1,322,930	$ 1,255,057	$ 1,183,784	$ 1,025,544
Electric Operating Expenses:					
Operation and maintenance*	594,041	596,353	546,253	457,267	389,242
Depreciation and amortization	194,334	160,298	139,541	99,221	87,494
Taxes**	318,047	323,204	305,909	320,312	285,548
Palo Verde cost deferral	(67,479)	(84,289)	(25,526)	—	—
Total	1,038,943	995,566	966,177	876,800	762,284
Operating Income	403,080	327,364	288,880	306,984	263,260
Other Income**	71,694	126,456	173,847	190,047	190,818
Interest Deductions - Net	203,563	156,057	188,607	171,608	156,508
Income from Continuing Operations Before Cumulative Effect of Accounting Change	271,211	297,763	274,120	325,423	297,570
Loss from Discontinued Operations - Net of Tax**	—	—	—	—	(26,503)
Cumulative Effect of Accounting Change - Net of Tax**	—	16,110	—	—	—
Net Income	271,211	313,873	274,120	325,423	271,067
Preferred Stock Dividend Requirements	33,319	32,950	39,279	44,412	48,375
Earnings for Common Stock	$ 237,892	$ 280,923	$ 234,841	$ 281,011	$ 222,692
Total Assets	$ 5,990,964	$ 5,818,588	$ 5,595,883	$ 5,251,327	$ 4,653,774
Long-term Debt and Redeemable Preferred Stock	$ 2,455,880	$ 2,503,928	$ 2,107,219	$ 2,425,361	$ 1,967,486
Common Stock Data:					
Book value per share	$ 27.12	$ 26.74	$ 25.76	$ 25.42	$ 24.18
Earnings (loss) per average common share outstanding:					
Continuing Operations Before Accounting Change	$ 3.34	$ 3.71	$ 3.30	$ 3.96	$ 3.65
Discontinued Operations	—	—	—	—	(0.39)
Cumulative Effect of Accounting Change - Net	—	0.23	—	—	—
Total	$ 3.34	$ 3.94	$ 3.30	$ 3.96	$ 3.26
Dividends declared per share	$ 2.96	$ 2.88	$ 2.94	$ 2.73	$ 2.60
Common shares outstanding:					
Year-end	71,264,947	71,264,947	71,264,947	71,264,947	70,128,329
Average	71,264,947	71,264,947	71,264,947	71,031,228	68,308,131
Number of common shareholders	1***	1***	1***	1***	124,274

* Certain prior year items have been reclassified to conform to 1988 presentation.

** Federal and state income taxes are included in Taxes, Other Income and Cumulative Effect of Accounting Change. Total income tax expense was as follows: 1988, $183,897,000; 1987, $197,314,000; 1986, $156,820,000; 1985, $165,279,000; 1984, $137,072,000. Palo Verde cost deferral included in Other Income for 1988, 1987 and 1986 was $79,432,000, $71,961,000 and $38,262,000, respectively; there was no such deferral in 1985 or 1984.

*** All the shares of common stock of the Company are owned by Pinnacle West Capital Corporation.

We did all this without impacting service to customers. Top-quality customer service remains APS' number one priority; customer satisfaction is the foundation for the future in an increasingly competitive market.

Our cost-cutting activities are vital to maintaining both our financial and rate stability, the latter a commitment we have made to our customers. The retail rate increase of 2.1 percent we were granted in April 1988 was our first increase in base rates since November 1986. We will file in 1989 and hope to gain Arizona Corporation Commission approval of a rate increase to take effect in January 1991.

We took a leadership role in our state's economic development in 1988 with an aggressive program designed to attract industries to our state, with special focus on Arizona's smaller communities. As a result, we brought six new commercial or industrial businesses into our service area and created more than $100 million in capital investments and some 1,100 new jobs for Arizonans. We're intensifying our efforts in 1989.

Our management team has made a commitment to turning our company into one that is more flexible, more aggressive and dynamic. Our challenge for 1989 is to increase revenues and to cut further our operating expenses while absorbing any inflationary increases, while seeking out new, non-traditional sources of future revenue.

In addition, an aggressive marketing program launched in 1987 is being revitalized with the recognition that satisfying customers requires providing solutions to their energy-related problems. Thus we are working closely with customers to develop partnerships on energy needs. For example, one new effort in 1989 is an Electronic Equipment Protection marketing program that recognizes the micro-chip sensitivity of today's high-tech business world by offering customers highest quality surge suppressor equipment.

The effort is not limited to marketing programs. All our employees are exceptional people who have committed to making customer service their number one priority. We are confident that — as with challenges we've faced in the past — we can and *will* manage today's challenges and pressures.

We invite you to study the detailed financial information in the following pages and to attend our Annual Meeting of Stockholders on April 18 in Phoenix.

Sincerely,

Keith L. Turley
Chairman of the Board

O. Mark De Michele
President and
Chief Executive Officer

To Our APS Preferred Shareholders:

A year ago we faced many challenges: an important rate case, a request for an accounting order for Palo Verde Unit 3, a need to reduce expenses and the reality of an increasingly competitive energy market.

We are pleased to report that we achieved our authorized rate of return in 1988; we saw the successful conclusion of a long and arduous rate case, including approval of the Unit 3 accounting order; and we earned $238 million, after payment of preferred dividends, from revenues of $1.4 billion; and billed electric sales increased to 17.8 million megawatt-hours, a 15 percent jump from 1987 levels of 15.4 million.

Additionally, we had the best employee safety record ever; our Four Corners Plant set new operating records; and Palo Verde Nuclear Generating Station units operated well above national averages, setting both domestic and international marks.

By the end of 1988, Palo Verde Unit 3 had generated more than 10 million megawatt-hours of electricity, more than any other nuclear plant in the country in any previous year.

Yet to be released this year is the final report of a Palo Verde Prudence Audit ordered by the Arizona Corporation Commission. During the audit we provided all documentation requested by the auditors and believe we made a good case. The final audit report is expected to be issued in the near future. We are convinced that Palo Verde is well-designed and well-built and are optimistic about the audit's final outcome.

So that we may continue to meet the challenges ahead we are continuing a rejuvenated marketing strategy and a renewed emphasis on service quality, combined with comprehensive cost reduction efforts throughout our company. Coupled with these are a broad range of activities designed to streamline our operation, enabling it to function more effectively in an increasingly competitive marketplace.

As a part of this streamlining, a major staff reduction was completed early in the year in which a total of 922 positions were eliminated. Of these, 503 were employees who left the company; the remainder were budgeted jobs left unfilled. Our goal is to eliminate another 300 positions through attrition by 1990.

We were also able to reduce our construction expenditures for 1988 by some $56 million, and expect 1989 capital expenditures to be down more than $40 million from our projections a year ago . . . for the first time in 25 years, we did not need to arrange any new, long-term external financing.

ABOUT THE COMPANY

Arizona Public Service Company (the "Company" or "APS") is engaged principally in the generation and sale of electricity. APS, a successor to a series of small utility operations originating in 1886, was incorporated in 1920 under the laws of Arizona and has operated under its present name since 1952. The Company's electric service reaches approximately 1,597,000 people, or about 45 percent of the state's population, in an area that includes all or part of 11 of Arizona's 15 counties.

All the shares of common stock of the Company are owned by Pinnacle West Capital Corporation ("Pinnacle West") (formerly AZP Group, Inc.), which became the Company's corporate parent, effective in April 1985, pursuant to a corporate restructuring. The restructuring did not affect the Company's preferred stock or any of its outstanding debt securities, all of which remain obligations of the Company.

ANNUAL REPORT

This report is published to provide general information concerning the Company and not in connection with any sale, offer for sale, or solicitation of an offer to buy, any securities.

ANNUAL MEETING OF STOCKHOLDERS

All stockholders are invited to attend the Company's sixty-ninth annual meeting at 10:00 a.m. on Tuesday, April 18, 1989 at the Sheraton Phoenix, 111 North Central Avenue, Phoenix, Arizona.

APS OFFICERS

Leslie N. Brockhurst, 42, Vice President, Human Resources
O. Mark De Michele, 55, President and Chief Executive Officer
Walter F. Ekstrom, 51, Executive Vice President, Engineering, Operations and Construction
Karl Eller, 60, Chairman of the Executive Committee
David W. Ellis, 50, Vice President, Engineering
Kathryn A. Forbes, 38, Vice President and Controller
Jerry G. Haynes, 54, Vice President, Nuclear Production
William J. Hemelt, 35, Treasurer and Assistant Secretary
Russell D. Hulse, 61, Vice President, Resources Planning
Charles D. Jarman, 53, Vice President, Construction
Donald B. Karner, 37, Executive Vice President, Nuclear
Nancy C. Loftin, 35, Secretary and Corporate Counsel
Jaron B. Norberg, 51, Executive Vice President and Chief Financial Officer
William J. Post, 38, Vice President, Finance and Rates
Shirley A. Richard, 42, Executive Vice President, Customer Service,
Marketing and Corporate Relations
Keith L. Turley, 65, Chairman of the Board

(Age on Annual Meeting date, April 18, 1989)

SHAREHOLDER INFORMATION

Stock Listing

The adjustable rate cumulative preferred stock, Series Q (Symbol ARPQ) is listed for trading on the New York Stock Exchange. The common stock of the Company is wholly-owned by Pinnacle West and as a result is not listed for trading on any stock exchange. Prior to April 29, 1985 the Company's common stock was publicly held and was traded on the New York and Pacific Stock Exchanges. At the close of business on April 28, 1985 the Company's common stock was held by 123,776 shareholders.

The chart below sets forth the dividends per share paid on the Company's common stock for each of the four quarters of 1988 and 1987.

Common Stock Dividends Per Share

Quarter	1988	1987
1st Quarter	$0.74	$0.72
2nd Quarter	0.74	0.72
3rd Quarter	0.74	0.72
4th Quarter	0.74	0.72

Transfer Agent and Registrar

Pinnacle West Capital Corporation
Stock Transfer Department
P.O. Box 52134
Phoenix, Arizona 85072-2134
(602) 222-6951

General Counsel

Snell & Wilmer
Phoenix, Arizona

Auditors

Deloitte Haskins & Sells
Phoenix, Arizona

Pinnacle West Capital Corporation Stock Purchase and Dividend Reinvestment Plan

A Prospectus describing this plan is available upon request. Write: Office of the Secretary, Station 1930, at the address below.

Form 10-K

A copy of our Annual Report to the Securities and Exchange Commission, Form 10-K, will be available after March 31, 1989, without charge, upon written request of shareholders. Write: Office of the Secretary, Station 1930, at the address below.

MAILING ADDRESS:

P.O. Box 53999
Phoenix, Arizona 85072-3999