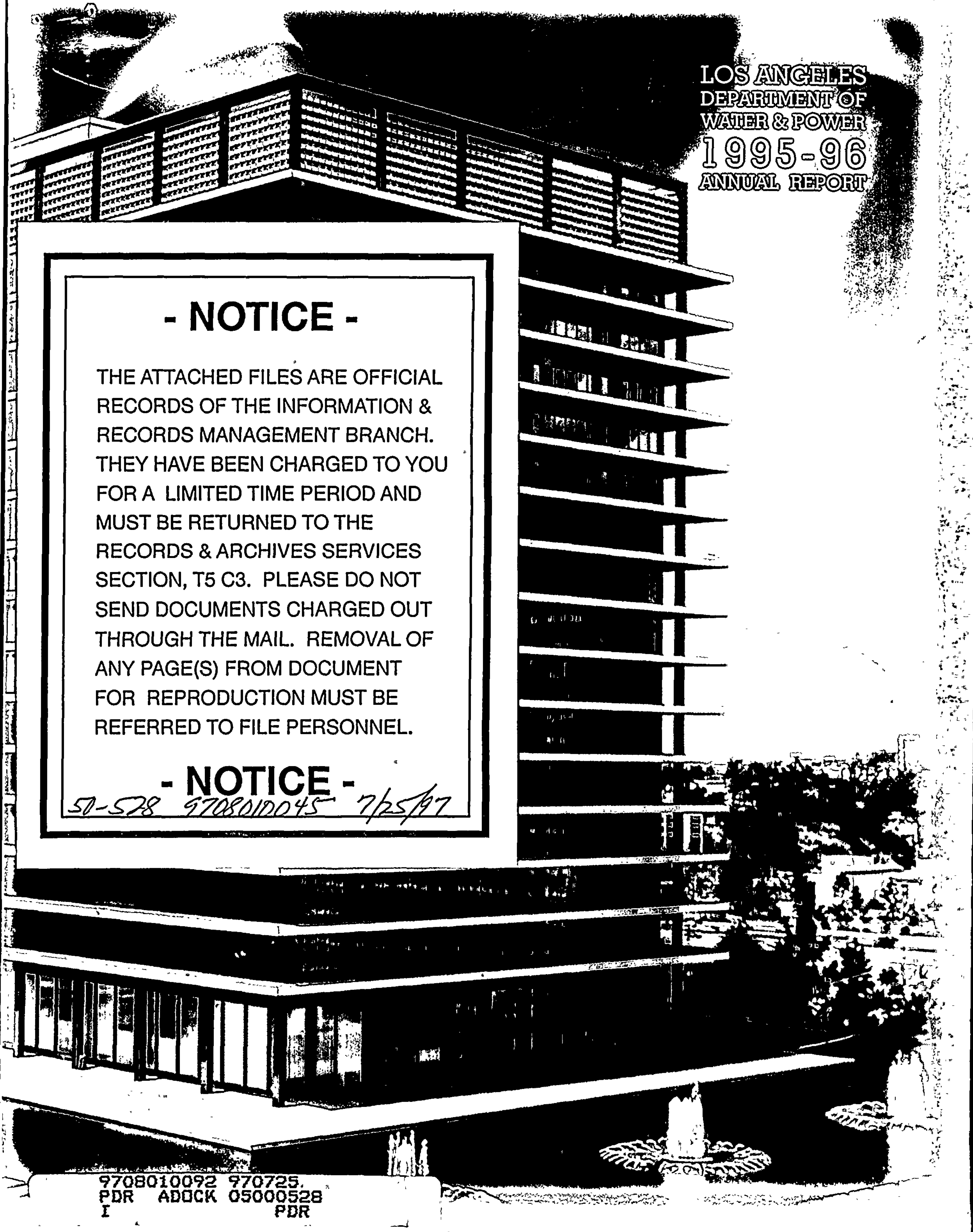
LOS ANGELES DEPARTMENT OF WATER & POWER

1995-96 ANNUAL REPORT



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A MESSAGE FROM THE GENERAL MANAGER

This past year brought the advent of an exciting time in the electric utility industry. With deregulation and open competition just around the corner, the Los Angeles Department of Water and Power has been actively gearing up for a new era in the industry.

Success in this new era will be defined by a number of factors. The ability of utilities to reduce debt, control costs and offer competitive rates and top-notch customer service will determine the winners in this new arena. The rapid changes that lie ahead in the industry underscore the significant financial and regulatory challenges that face municipal utilities like LADWP.

At LADWP, we're up to the challenge. In Fiscal Year 1995-96, we worked aggressively to reduce operating costs, and as a result, our net income for our Energy Services Business increased by $73 million over the previous year, and our Water Services Business jumped by $66 million. We've also embarked on an aggressive debt-reduction strategy to further reduce our annual costs and to better position LADWP in a competitive market.

And we've focused our energies on our customers. We're responding to what our customers are saying. We've begun providing new services, like a bill that's easier to understand, an Internet home page to provide up-to-date information, and more convenient payment options. We even started an advertising campaign to heighten public awareness of LADWP's long-standing reliability and commitment to provide water and electric service to the residents and businesses of Los Angeles.

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DEPARTMENT OF WATER AND POWER

William R. McCarley
General Manager

Kenneth S. Miyoshi
Assistant General Manager and Chief Engineer

Eldon A. Cotton
Assistant General Manager – External Asset Management & Restructuring

James F. Wickser
Assistant General Manager – Water Services

Thomas M. McCloskey
Assistant General Manager – Marketing And Customer Service

Faye Washington
Assistant General Manager – Chief Administrative Officer

Phyllis E. Currie
Chief Financial Officer

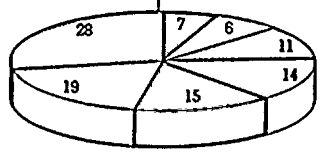
With savings in the past two years of nearly $184 million, we wanted to pass along some of our efficiency improvements to our customers. For our large commercial and industrial customers, we've developed an electric rate proposal that will reduce their bills by $25 million and unbundle prices to help our customers make informed comparisons of equal services.

This past fiscal year brought a historic success in LADWP's labor relations. Rather than engage in acrimonious battles between labor and management, we have joined together against a common foe — our competitors. With a commitment from our employees to identify productivity and efficiency improvements, we've formed a winning partnership that will ensure our success in a competitive market.

The coming year will bring a change in leadership at LADWP. It is with a mixture of emotions that I pass on the honor of leading the Department into a new era. It has been my great privilege to serve as LADWP's general manager for the past two years. I am proud of the strides we have made to position the Department for the competitive market. A great deal of work still lies ahead, but with the dedication and commitment of our employees and our leadership, unprecedented success awaits LADWP.

William R. McCarley
General Manager

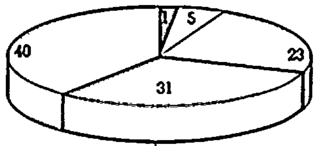
REVENUE AND EXPENDITURE DOLLAR



WATER EXPENDITURE
DOLLAR IN CENTS

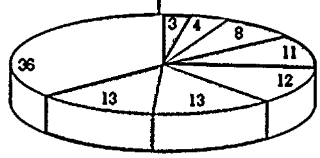
28 Capital improvements
19 Other operating expenses
15 Operating salaries and wages
14 Debt service costs
11 Purchased water
7 Retirement Plan costs related to operations
6 Transfers to the City*

*Includes payable of $6.0 million



WATER REVENUE
DOLLAR IN CENTS

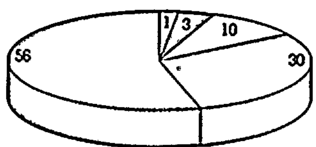
40 Single dwelling residential
31 Multi-dwelling residential
23 Commercial and industrial
5 Governmental
1 Other



POWER EXPENDITURE
DOLLAR IN CENTS

36 Purchased energy
13 Other operating expenses
13 Debt service costs
12 Operating salaries and wages
11 Capital improvements
8 Fuel
4 Transfers to the City*
3 Retirement Plan costs related to operations

*Includes payable of $8.9 million



POWER REVENUE
DOLLAR IN CENTS

56 Commercial
30 Residential
10 Industrial
3 Other
1 Street lighting

COMPARATIVE HIGHLIGHTS

	WATER			POWER		
Year ended June 30	1996	1995	% Increase (Decrease)	1996	1995	% Increase (Decrease)
SERVICE	GALLONS IN BILLIONS			KILOWATT HOURS IN BILLIONS		
Sales	190.6	179.1	6.4%	22.2	21.7	2.3%
Customers — average number (thousands)	642.1	638.2	0.6%	1,350.8	1,338.5	0.9%
FINANCIAL	IN MILLIONS			IN MILLIONS		
Revenue (A)	$ 438.0	$ 411.3	6.5%	$1,971.0	$1,994.6	(1.2%)
Operating Costs (B)	212.2	255.2	(16.9%)	1,401.8	1,548.5	(9.5%)
Net Income	119.9	54.1	121.6%	132.7	59.9	121.5%
Transfers to City of Los Angeles (C)	20.2	40.0	(49.5%)	59.9	69.3	(13.6%)
Capital additions, net	152.6	140.4	8.7%	211.0	230.0	(8.3%)
Net utility plant	1,890.0	1,795.0	5.3%	4,612.5	4,663.6	(1.1%)
Capitalization — equity and long-term debt (D)	1,987.6	1,877.7	5.9%	4,864.7	4,851.0	0.3%

(A) Includes other income and expenses – net

(B) Excludes depreciation expense

(C) Includes Water Services payable of $6.0 in 1995
Includes Energy Services payable of $8.9 and $11.7 in 1996 and 1995, respectively

(D) Excludes advance refunding bonds

IT'S A WHOLE NEW BALL GAME, AND WE'VE TAKEN THE FIELD

The utility business has changed . . . forever. And so have we. Our role as a proven, reliable provider of water and energy has brought us to this pivotal point in time. Our vision and ability to adapt will enable us to be the provider of choice in a future where we're not the only game in town.

Our strategy has one focus: our customers. We're listening and responding to their needs. We're approaching them in new ways and partnering for innovative, mutually beneficial solutions.

To make these new inroads, we took a hard look at our organization from top to bottom. We revamped our employee team and are equipping them with new skills and resources. Our efficiency measures have resulted in profound cost savings.

These pages illustrate the activities and challenges of fiscal year 1995-96, during which our whole industry sped toward deregulation and competition. They show how we worked hard to meet these new challenges and be ahead of the game in a new era.

■ ■ ■

We're a municipal water and energy utility whose owners are the people of Los Angeles. These residential and business customers have the right to expect and receive excellent service, low rates and a reasonable dividend.

We've been bringing water and electricity to Los Angeles since the opening decades of this century. For most of the 20th century, DWP has had the exclusive right to sell these commodities to our customers — but we were also responsible for maintaining near-perfect service and for developing the infrastructure and resources for the explosive growth in the second half of the century.

We made good on that responsibility. Today, DWP is the largest municipally owned utility in the nation, with a consumer base of more than 3.6 million people


CROSSING
PIPELINE
#5 @ 12
24" OR GREATER O.D.
3/4" THK x PREMOLDED EXP JOINT FILLER
6" (TYP)
PIPELINE
APERTURES WHERE REQ'D. SEE NOTE 3
3/4 O.D. MIN.
D
SECTIONS
NOTE 5, TYP
CROSSING
TYPICAL CROSSING PIPE
FOR PIPELINES GREA
NTS
CONC
CROSSIN
D.I. CROSS CONDUI
REPLACING EXISTING
SECTION
B

"I was happy with the excellent help Louis gave us. He helped us to do everything right to get our permit and pay for our new water service."
Polo Hurtado, Owner

Polo Hurtado updates Louis Wagner, DWP commercial account representative, on his body shop's modifications.

To avoid parking violations, Polo's Body Shop had to expand its parking area. The City's construction permitting process required new water hookups for fire service, and DWP's normal procedure would have billed this improvement in a large lump sum which the owner could not afford. Working as a customer advocate with the City's Building and Safety Division and DWP's Water Operating Supervisor Cecilia Weldon, Louis Wagner was able to get a Board resolution to extend a payment plan for the water service improvements.

and an excellent reliability record. We balance resource acquisition from our own water and electricity resources with that from other suppliers to serve our customers' needs. At the same time, we keep our rates competitive with those of other California municipal and investor-owned utilities.

The electric utility industry is moving from a monopoly to an open market that relies on competition to set the price of electricity generation. What's driving this drastic change? New technology is enabling power plants to generate electricity at lower costs using currently inexpensive natural gas. At the same time, worldwide economic forces are pressuring California's industries to become more competitive. Customers want lower cost energy, and the technology and federal laws exist to allow this market transformation.

In December 1995, the California Public Utilities Commission proposed the components of a deregulated electricity market in California. Gov. Pete Wilson signed the resulting legislation in September 1996. The legislation:

- Creates an Independent System Operator to oversee the high voltage transmission system.
- Creates a Power Exchange as a generation auction market for buying and selling electricity.
- Allows customers of investor-owned utilities to choose their electricity supplier (starting in January 1998 and phasing in all customers by 2002).
- Gives municipal utilities the option of offering direct access with City Council approval.
- Permits utilities to recover their costs for stranded generation assets from customers.
- Mandates a 10 percent rate reduction for residential and small commercial customers served by investor-owned utilities by January 1998, and an additional 10 percent by 2002.
- *Allows customers to continue to rely on service from local utility companies as they have in the past, if they are happy with their current supplier and don't wish to switch to a new competitor.*

We want our customers to stick with us. To be their provider of choice, we are reshaping our organization and developing new products and services — innovations that will keep us competitive in the free market just around the corner.

Our single strategic focus for this new era is . . . the customer.

CUSTOMERS

We have always provided reliable water and power service at reasonable prices. Now, to retain our customers' loyalty, we can no longer assume that we know what they need. We have to be intent, responsive listeners.

Here are some of the innovations we launched in 1995-96 to get on our customers' wavelength:

Marketing Organization We created a new Marketing and Customer Service Organization and structured it around our various customer classes. This allows the Department to hear and respond more effectively to specific customer concerns. The organization can also quickly respond to market pull for new products and services, and develop potential revenue opportunities.

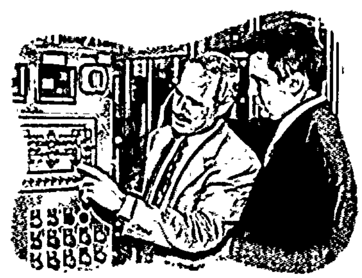
Advertising Campaign To generate public awareness and support for DWP in a competitive environment, we launched a strategic advertising and public relations campaign. It brings customers the vision of DWP as a forward-looking utility, and reminds them of our history, reliability and expertise. The first phase was launched in May 1996 when our advertisements began appearing in major newspapers and on radio stations, billboards and buses. Market research tells us that customer response to this campaign has been favorable.

New Approach to Large Customers Our largest customers are the ones most likely to be lured away by other providers. Our success hinges on our ability to understand these customers' needs and sign multi-year partnership agreements with them with long-term reciprocal benefits. DWP is aggressively pursuing these efforts to help provide financial stability and maintain market share.

We created a Premier Service Accounts (PSA) program to identify and meet the needs of our 40 largest and most profitable commercial and industrial customers. These customers represent over $300 million in annual revenue to the Department. The PSA program allows the Department to better understand and address their needs by creating customer-sensitive account plans.

"We rely heavily on consistency and quality in both water and power. Any fluctuation in either commodity has a major impact on our operations. We are pleased with DWP's understanding of our needs and with the quality of service they provide."

Jeff Silverman, Director of Technical Operations



Jeff Silverman explains the power requirements of Alpha's water purification system to Massoud Ghaemi, DWP's industrial account executive.

A worldwide developer of plasma-derived biopharmaceutical products, Alpha Therapeutic recently undertook a $45 million expansion at their Los Angeles facility. DWP personnel became involved in the planning process and installed a new substation at the site before the new facility was built. DWP also proactively responded to power outages from vulnerable streetside distribution lines and reconfigured the circuits to improve service reliability.

"I believe this agreement makes both our businesses better. It shows that DWP is willing to create new concepts for dealing with its customers in a time when the energy industry is changing radically."

David N. Johnson, Director of Energy Services

Christopher Moser, DWP commercial service representative, and David Johnson discuss the UCLA power plant's generation levels.

The Department formed a long-term strategic partnership with UCLA to exchange mutually beneficial services and products. These include such diverse elements as exchanging parts and materials and sharing air quality information. The agreement includes a joint public disaster coordination plan, and UCLA has agreed to provide DWP with generation backup in the event of an emergency and during scheduled outages.

New and Enhanced Services To offer our customers more choices and services, we combined DWP's strengths with those of the Southern California Gas Company and the Energy Management Services (EMS) unit of Pacific Enterprises to form the Energy Alliance. This significant partnership, which integrates the energy services of DWP's electricity, the Gas Company's gas distribution and the EMS group's district heating and cooling, will provide innovative energy management solutions for customers. The Energy Alliance will provide customer-focused solutions, like allowing the energy use of a large facility or complex to be regulated from a central location.

State-of-the-art Technology Some of our product and service innovations are based on advances in technology:

- DWP continues to provide the infrastructure and a discounted electric rate for electric vehicles that increases our revenue opportunities by providing a value-added service to our customers.
- We introduced our Internet Home Page at http://www.ladwp.com. This Web site includes information on DWP business and residential services, emergency information, conservation tips, and the latest events.
- Remote meter reading technology may soon allow us to read our nearly 2 million electric and water meters from one central location. We're conducting various pilot programs with residential and commercial customers to evaluate the benefits of automated systems.
- By leasing rights-of-way for fiber optic cables over our transmission and distribution system, we have expanded the Department's revenue opportunities. Our vision for a telecommunication infrastructure that utilizes state-of-the-art technology led us to team with telecommunication companies to establish links with customers at reduced costs.

New Bill DWP introduced a new "municipal services" bill format that makes it easier for residential customers to read and understand their charges for city services. The bill includes a streamlined summary of charges along with the telephone number of each service agency. This new bill helps our customers understand where their city service dollar goes and who to call for questions.

New Payment Options Many of our residential customers travel abroad or are too busy to remember when their bimonthly municipal services bill is due. So, we created new payment options for them. Customers can have their payments electronically wired to DWP from any Western Union office for immediate credit.

"This system helps us meet air conditioning requirements on the sound stages during peak hours and saves us a lot of money on energy at the same time."

Gary Gillett, Manager of Facility Engineering

Surrounded by the thermal energy storage system's colorful pipes, Mariko Mariames, DWP marketing representative, and Gary Gillett review energy usage records.

Most television shows are taped in the afternoon, when commercial electricity rates are highest. TV stars sometimes require temperatures as low as 50 degrees on their huge sound stages. With DWP cash incentives, CBS purchased and installed two thermal energy storage systems that make and store ice at night when commercial rates are lowest. Then, during the day when rates are higher, only energy-efficient pumps and fans operate, circulating chilled water and air to provide air conditioning. The result: CBS has been able to shift 976 kilowatts of electrical demand from on-peak to base period rates.

They may also pay by credit card, by debiting a personal checking account or by a computer-generated payment.

Reduced Call Waiting Time Customer calls to DWP are now handled quicker and more efficiently due to several changes in our Customer Call Center, which was reorganized to utilize a team concept for answering customer calls. Customers applying for a new service can now fax their applications to DWP for their convenience. Additionally, our customers can now request information about conservation, low-income programs and lifeline rates through the Call Center.

Community Relations We never forget that our customers and the community are the same people. So we have strengthened our resolve to be good neighbors as we maintain our infrastructure and take care of customer needs.

We've created a Community and Business Alliances Group to improve relationships with community stakeholders. The group will raise public awareness and visibility of the new, competitive DWP through direct involvement with grass roots community groups in Los Angeles.

COST CUTTING

For Customers To help our large commercial and industrial customers cut their electricity costs (and to improve our competitive ability), we developed a three-pronged electric rate proposal. First, we propose to restructure rates so that prices are in line with our costs. Next, we want to unbundle prices to reflect generation, distribution and transmission charges. This will help our customers make intelligent comparisons of equal services. Finally, we aim to reprice rates for our largest commercial and industrial customers, passing along $25 million in savings from our increased efficiencies.

For DWP We set a goal of reducing costs by at least $160 million over the 1995 and 1996 fiscal years, and we went over the top (See the numbers in the Financial Highlights starting on page 15). Net actual savings over the two-year period are

"This is a unique example of a public and private collaboration which seemed impossible five years ago. By meeting halfway and brainstorming, we came up with a solution that benefits everyone involved."

Jean Barrett, board member, Hollywood Knolls Community Club (member organization of the Coalition to Preserve Open Reservoirs)

Richard Harasick, DWP engineer, and Jean Barrett recap the latest water quality improvements at Lake Hollywood.

Facing stringent water quality regulations at its open reservoirs, DWP made plans in 1988 to install reservoir covers and/or build full-scale filtration plants in adjacent residential neighborhoods. To protest these plans, 15 community groups and homeowner associations formed the Coalition to Preserve Open Reservoirs (CPOR). Through a mediation process in 1990, DWP and CPOR worked together to consider alternatives. The solution at Lake Hollywood included buried water storage and a small filtration plant at the base of the dam. The result: Residents are able to live with the project, DWP now complies with surface water requirements and DWP customers enjoy improved water quality.

expected to approach $184 million. In addition, we have identified $66 million in potential future revenue opportunities. A series of ongoing cost-cutting measures will continue into the new fiscal year. The 1996-97 budget submitted to the DWP Board totaled $96 million less than the prior fiscal year.

We cut our expenses with a combination of staffing changes, efficiency and productivity gains, technological advances and more effective asset management. Here are some examples:

- Our support services such as fleet services, facilities management, human resources and records management were formerly spread across the Department. In the last year, we centralized these functions under one umbrella organization (the Central Services Organization, or CSO). Also, by moving purchasing and stores functions to CSO, we can now manage and reduce administrative overhead costs in these areas.
- Our water business has been faced with increased capital expenditures as it grapples with new water quality requirements and upgrading its aging infrastructure. Even so, its resourceful managers and employees have devised ways to spend less on these capital improvements. For example, the Cement Mortar Lining Program, aimed at improving the water quality by removing corrosion deposits from aging pipes, saves 66 percent over the cost of replacing water mains, and minimizes customer disturbance.
- Conservation practices and wet weather kept our Los Angeles Aqueduct full, allowing us to sharply reduce the purchase of higher cost water from the Metropolitan Water District.
- We consolidated the Department's 150 electrical substations under the Distribution Business Unit. This will give the Department a centralized accountability for managing and reducing substation design and operation costs.
- Accelerated debt reduction and refinancing efforts have begun to reduce the cost of our debt service.

EMPLOYEES

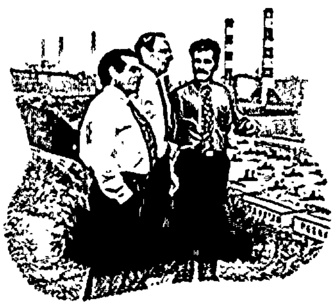
Our employees probably experienced more organizational and cultural changes during this fiscal year than ever before. Yet as they said goodbye to some of their longtime colleagues, they began retooling for the coming challenges.

Focused Separation Program As part of our reorganization, we evaluated our workforce and identified areas which were overstaffed. We offered a Focused Separation Program (FSP) to encourage employees in these classes to resign. The FSP also encouraged eligible workers in all classes to retire from the Department. As a result, 1,216 employees took the package, yielding a savings of $86 million per


GRAND
We're making sure the
future is brigh
W

"Our agreement with DWP amounts to an energy swap: digester gas for electricity. This exchange allows us to bring in higher electrical demand to meet the new stricter federal mandates for wastewater treatment at a tremendous cost savings for the City."

Homayoun R. Moghaddam, Manager, Energy Recovery System Engineering



Homayoun Moghaddam (right) explains Hyperion's expansion plans to DWP representatives Jafar Bazzaz, electrical engineer, and John Schumann, manager of external generation assets.

Hyperion Treatment Plant needed additional power sources to run the equipment so the plant could meet stricter federal treatment mandates. The Department of Public Works considered building a $54 million co-generation facility there to produce electricity from digester gas. Making the same electricity with the same digester gas at DWP's adjacent Scattergood Generating Station would cost only $12 million in new construction and save the City an estimated $42 million. Hyperion agreed to transport the gas by pipeline to Scattergood. In return, DWP retained a highly valued customer whose electricity costs were significantly reduced.

year. With the FSP, a hiring freeze, and an aggressive outplacement effort, the Department has reduced staffing levels two years ahead of schedule. By reorganizing our business units and further defining accountabilities within them, we will continue to reduce employee levels and still maintain our high service standards.

Reskilling Our new MEGA Center is big in name and concept: Maximizing Employee Growth and Achievement is the goal of this new interactive, multimedia learning and resource facility. It provides professional education and job training skills to help employees prepare to meet the Department's competitive challenges. Here employees can receive classroom training in various business skills such as computer applications in self-paced learning labs. The Center offers Department-wide skills retraining and supports on-the-job training. Employees will be able to improve their skills and even check out interactive computer programs that allow them to learn at home.

Labor Agreement Faced with staff reductions and significant organizational changes, we worked to build a solid working relationship with all DWP labor organizations. For the first time, we negotiated a four-year contract with the International Brotherhood of Electrical Workers, Local 18, through the mutual gains process before the existing contract expired. This landmark contract matches salary increases to efficiency improvements.

In addition, Joint Labor Management Teams have been organized to examine issues of mutual interest, including customer service, staffing priorities, worker safety, substation area consolidation, in-basin generation and service reliability.

Refocusing Employee Attention on Customers We realized that all employees need to think of customer service in every aspect of their jobs, whether they interface with internal or external customers. The Service Guarantee process, which was piloted in the Department's Central Services Organization (CSO), is a way to change the culture at DWP to a more service-oriented attitude. As a result of the process, employees become more customer-focused — a necessary organizational characteristic that is critical if DWP is to thrive in a competitive environment. The implementation of this program in CSO ensures that our internal service delivery system is in place, which provides the basis for services to be delivered to our external customers.

Safety During 1995, the number of injuries we were required to report to the Occupational Safety and Health Administration dropped by 34 percent. In addition, total injuries decreased by 1.9 percent while total work days lost due to injuries decreased by 20 percent.

"DWP has made considerable efforts over the last two years to listen to our needs and concerns. Its representatives have demonstrated this by quickly responding to our questions. In this way, DWP has shown us that we are a valued customer."

M. Ramadan, Superintendent of Reliability Engineering

FINANCIAL HIGHLIGHTS

The financial picture for 1995-96 was bright, reflecting our cost containment and new revenue goals. Water Services and Energy Services net income combined was more than double the 1994-95 amount. The previously mentioned Focused Separation Program resulted in a workforce reduction of 1,216 employees at an annual cost savings of $86 million. In fiscal year 1995-96, we continued to improve cost containment and productivity which further reduced costs and staffing levels.

Thomas McCarthy, DWP engineer of distribution system design, and M. Ramadan review system plans at 76 Products' Wilmington refinery.

Overhead transmission lines at the Wilmington refinery were vulnerable to frequent failures from vehicular traffic dust, salt-water vapor contamination and contact with animals, birds and metallic balloons. These failures resulted in severe power disturbances that disrupted the plant's operation. DWP rerouted the transmission lines underground and helped to improve the plant's productivity and profitability.

WATER SERVICES

Higher sales and lower expenses gave Water Services a net income of $120 million, an increase of $66 million over FY 1994-95.

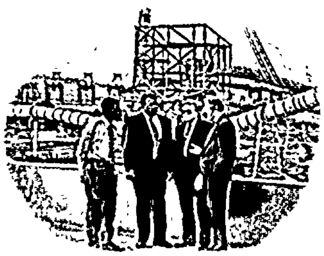
Our water sales increased by 6.4 percent over the previous year, primarily because of warmer weather. These sales increased our total Water Services' operating revenue to $423 million.

Water Services' operating expenses dropped by $40 million or 13 percent from 1994-95 levels to $271 million. We achieved this reduction by containing costs and buying less water from other agencies. The plentiful snowpack in the eastern Sierras allowed us to rely on our own less expensive internal water resources.

To maintain our aging infrastructure and meet new water quality regulations, the Water Services' capital expenditures are increasing. In fiscal year 1995-96, capital expenditures were $153 million, $12 million more than last year. In the next four years, we expect the capital expenditure program to average $278 million a year.

"This has been an extremely successful partnership. We have been impressed with DWP's quality and ability to deliver."

Vernon E. Hall, Director of Development



DWP's Claudius Haynes, overhead distribution designer, and Mickey Walker, district superintendent, review construction progress with Vernon Hall and Adam Birkenbach, chief harbor engineer.

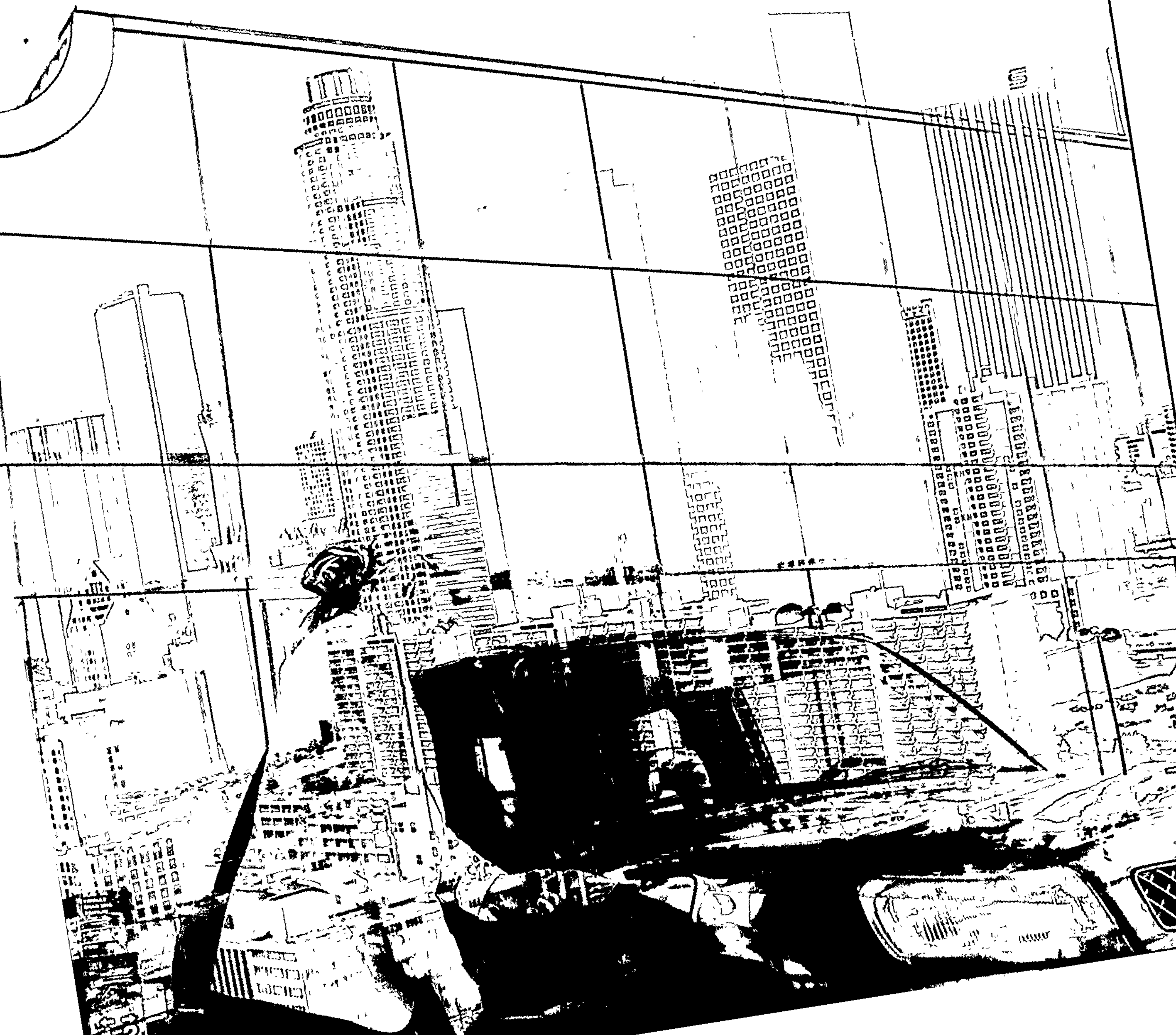
The Port of Los Angeles is undergoing the largest capital improvement program of any U.S. seaport. This $600 million project includes construction of two new piers and dredging to accommodate the largest container ships and dry bulk carriers in the world. DWP is working closely with the Port's designers and construction management to provide power and water services for the new Port facilities and meet completion deadlines.

ENERGY SERVICES

In fiscal year 1995-96, we increased sales and substantially reduced our operating expenses. The result: a net income of $133 million, a $73 million increase over FY 1994-95.

Our Energy Services sold 22.2 billion kWh, up 2.3 percent over last year's level, because of warmer weather coupled with improved economic conditions in Southern California. Our operating revenues were down by $26 million or 1.3 percent over the previous fiscal year, because we lowered our customers' bills when we paid less for fuel and purchased power and passed along the savings.

Our total operating expenses decreased by $118.6 million or 6.8 percent from 1994-95 levels because of the Focused Separation Program, continued staff reductions and other cost containment initiatives. The Energy Services' capital expenditures for FY 1995-96 were $211 million, approximately 8.3 percent lower than the prior year. We believe that we will spend less on capital improvements by limiting and focusing our expenditures on priority infrastructure needs to compete effectively under the coming electric industry deregulation.



1995 - 1996 FINANCIAL STATEMENTS

WATER SERVICES BALANCE SHEET

(In Thousands)	June 30 1996	1995
ASSETS		
Utility Plant, at original cost		
Source of water supply	$ 266,771	$ 264,783
Pumping	156,149	154,517
Purification	177,672	166,979
Distribution	1,750,008	1,648,169
General	267,746	268,240
	2,618,346	2,502,688
Less – Accumulated depreciation	875,295	816,898
	1,743,051	1,685,790
Construction work in progress	146,981	109,160
Net utility plant	1,890,032	1,794,950
Escrow Accounts - Advance refunding bonds	173,613	216,917
Current Assets		
Cash and investments	89,242	101,452
Customer and other accounts receivable, less $8,000 (1996) and $5,400 (1995) allowance for losses	65,831	66,625
Due from Energy Services	17,665	21,535
Accrued unbilled revenue	44,314	37,971
Materials and supplies, at average cost	15,544	14,223
Prepayments and other current assets	26,447	19,518
Receivable from U.S. Government - FEMA	9,772	7,041
Total current assets	268,815	268,365
Total utility plant and assets	$ 2,332,460	$ 2,280,232
CAPITALIZATION AND LIABILITIES		
Capitalization		
Equity		
Retained income reinvested in the business	$ 798,508	$ 698,874
Contributions in aid of construction	506,734	484,961
	1,305,242	1,183,835
Long-term debt	682,351	693,904
Advance refunding bonds	170,220	215,440
Total capitalization	2,157,813	2,093,179
Current Liabilities		
Long-term debt due within one year	14,280	13,910
Accrued interest	14,674	15,575
Accounts payable and accrued expenses	82,493	79,238
Over-recovered costs	19,029	28,871
Customer deposits	44,171	43,459
Transfer payable to the reserve fund of the City of Los Angeles	–	6,000
Total current liabilities	174,647	187,053
Commitments and Contingencies		
Total capitalization and liabilities	$ 2,332,460	$ 2,280,232

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

WATER SERVICES STATEMENT OF INCOME

(In Thousands)	1996	1995	1994
		Year ended June 30	
Operating Revenues			
Residential	$ 166,627	$ 150,790	$ 163,546
Commercial and industrial	230,477	228,611	237,714
Other	25,772	25,529	29,307
Total operating revenues	422,876	404,930	430,567
Operating Expenses			
Purchased water	47,285	64,662	94,376
Other operating expenses	102,683	137,682	142,319
Maintenance	62,261	42,452	40,010
Depreciation	58,730	56,173	53,331
Focused separation program	–	10,436	–
Total operating expenses	270,959	311,405	330,036
Operating Income	151,917	93,525	100,531
Other Income and Expenses, Net	15,168	6,324	2,333
Income before debt expenses	167,085	99,849	102,864
Debt Expenses			
Interest on debt	48,417	46,810	43,963
Allowance for funds used during construction	(1,213)	(1,110)	(1,048)
Total debt expenses	47,204	45,700	42,915
Net Income	$ 119,881	$ 54,149	$ 59,949

STATEMENT OF RETAINED INCOME REINVESTED IN THE BUSINESS

(In Thousands)	1996	1995	1994
		Year ended June 30	
Balance at beginning of year	$ 698,874	$ 684,725	$ 645,272
Net income for the year	119,881	54,149	59,949
	818,755	738,874	705,221
Less – Transfers to the reserve fund of the City of Los Angeles	20,247	40,000	20,496
Balance at end of year	$ 798,508	$ 698,874	$ 684,725

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

WATER SERVICES STATEMENT OF CASH FLOWS

(In Thousands)	Year ended June 30 1996	1995	1994
Cash Flows from Operating Activities:			
Net income	$ 119,881	$ 54,149	$ 59,949
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	58,730	56,173	53,331
Allowance for funds used during construction	(1,213)	(1,110)	(1,048)
Provision for losses on customer and other accounts receivable	8,161	5,352	5,516
Changes in current assets and liabilities:			
Customer and other accounts receivable	(7,367)	(16,696)	4,908
Due from/to Energy Services	3,870	(49)	16,418
Accrued unbilled revenue	(6,343)	(2,377)	(2,175)
Materials and supplies	(1,321)	2,887	128
Prepayments and other current assets	(6,929)	(6,490)	4,633
Receivable from U.S. Government - FEMA	(2,731)	859	(7,900)
Accrued interest	(901)	1,449	1,468
Accounts payable and accrued expenses	3,255	13,586	(8,874)
Over/under-recovered costs	(9,842)	29,867	(34,898)
Customer deposits	712	(274)	(579)
Net cash provided by operating activities	157,962	137,326	90,877
Cash Flows From Financing Activities:			
Sale of revenue bonds	-	99,000	-
Sale of advance refunding bonds	-	-	148,405
Amount deposited in escrow accounts related to advance refunding bonds	-	-	(148,425)
Amount received from escrow account, net	43,300	19,394	12,688
Contributions in aid of construction	21,773	16,221	11,399
Reduction of long-term debt	(11,183)	(13,282)	(13,115)
Long-term debt redeemed, including call premium	(45,216)	(17,887)	(12,688)
Transfers paid to the reserve fund of the City of Los Angeles	(26,247)	(34,000)	(20,496)
Net cash (used in) provided by financing activities	(17,573)	69,446	(22,232)
Cash Flows From Investing Activities:			
Additions to plant and equipment, net	(152,599)	(140,353)	(130,298)
Cash and investments:			
Net (decrease) increase	(12,210)	66,419	(61,653)
Beginning of year	101,452	35,033	96,686
End of year	$ 89,242	$ 101,452	$ 35,033
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	$ 59,672	$ 56,251	$ 41,900

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

NOTE A — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

THE DEPARTMENT — The Department of Water and Power of the City of Los Angeles (the "Department") exists under and by virtue of the City Charter enacted in 1925 as a separate proprietary agency of the City. Water Services is responsible for the procurement, quality and distribution of water for sale in the City.

METHOD OF ACCOUNTING — The accounting records of Water Services are maintained in accordance with generally accepted accounting principles (GAAP) for rate-regulated enterprises, as prescribed by the Financial Accounting Standards Board (FASB) and, where applicable, the Governmental Accounting Standards Board (GASB). The accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the California Public Utilities Commission (CPUC), except for the method of accounting for contributions in aid of construction described below.

The Department's rates are subject to review and approval by the City Council. As a regulated enterprise, the Department's financial statements are prepared based on the concepts of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS 71), which require that the effects of the ratemaking process be recorded in the financial statements. Such effects primarily concern the time at which various items enter the determination of net income in order to follow the principle of matching costs and revenues. Accordingly, Water Services records various regulatory assets and liabilities to reflect the regulator's actions. Management believes that Water Services meets the criteria for continued application of SFAS 71, but will continue to evaluate significant changes in the regulatory and competitive environment to assess Water Services' overall compliance with such criteria.

UTILITY PLANT — The costs of additions to utility plant and replacements of retired units of property are capitalized. Costs include labor, materials, an allowance for funds used during construction and allocated indirect charges such as engineering, supervision, transportation and construction equipment, retirement plan contributions, health care costs, and certain administrative and general expenses. The costs of repairs and minor replacements are charged to appropriate maintenance accounts. The original cost of property retired, plus removal cost, less salvage, is charged to accumulated depreciation.

DEPRECIATION — Depreciation expense is computed using the straight-line method based on estimated service lives. Estimated service lives range from 5 to 70 years. Depreciation provision as a percentage of average depreciable utility plant in service was 2.7% for each of the fiscal years 1996, 1995 and 1994.

ESCROW ACCOUNTS — Effective July 1, 1994, the Department adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities," which established new financial accounting and reporting standards for investments in debt and equity securities. Water Services' escrow accounts qualify under the definition of debt securities and are classified as held-to-maturity. Escrow accounts are held in external trust funds to be used for calling revenue bonds at scheduled maturity dates. These investments are reported at amortized cost. The adoption of this statement did not have a material effect on the financial position or results of operations of Water Services.

The proceeds received during fiscal year 1996 from the maturity of Water Services' escrow investments were approximately $50 million.

CASH AND INVESTMENTS — The Department's cash is deposited with the City Treasurer who invests the funds in securities under the City Treasurer's pooled investment program. Under the program, available funds of the City and its independent operating departments are invested on a combined basis. These investments are valued at cost, which approximates market. At June 30, 1996 and 1995, cash and investments include $15 and $15 million, respectively, of internally designated balances relating to bond redemption and interest funds, a self-insurance fund, and a retiree health care cost fund. The Department considers all cash investments with an original maturity of three months or less to be cash equivalents.

Contributions in aid of construction — Under the provisions of the City Charter, amounts received from customers and others for constructing utility plant are combined with retained income reinvested in the business and represent equity for purposes of computing Water Services' borrowing limits. Accordingly, contributions in aid of construction are shown in the accompanying balance sheet as an equity account and are not offset against utility plant.

Revenues — Revenues consist of billings to customers for water consumption and include amounts resulting from a cost adjustment formula designed to permit the full recovery of purchased water and other expenditures specifically approved for inclusion by rate ordinance. Beginning in February 1993, the Department was also authorized to collect certain demand-side management and water reclamation expenditures, and expenditures to upgrade water quality and to improve facilities to meet State and Federal water quality standards; a substantial part of these revenues relate to billings for water reclamation and water quality expenditures and are dedicated to those capital projects. The Department estimates these costs to establish the above cost recovery component of customer billings and any difference between billed and actual costs, resulting in over- or under-recovery of such costs, is adjusted in subsequent billings.

Water Services recognizes recoverable costs in the period incurred and accrues for estimated water sold but not yet billed.

Water Services' rates are established by a rate ordinance which is approved by the City Council. Water Services sells water to other departments of the City at rates provided in the ordinance.

Debt expenses — Debt premium, discount and issue expenses are deferred and amortized to expense over the lives of the related debt issues.

Allowance for funds used during construction (AFUDC) — AFUDC represents the cost of borrowed funds used for the construction of utility plant. Capitalized AFUDC is shown as part of the cost of utility plant and as a reduction of debt expenses. The average AFUDC rates were 6.4%, 6.3% and 6.5% for fiscal years 1996, 1995 and 1994, respectively.

Reclassification — Certain financial statement items for fiscal years 1994 and 1995 have been reclassified to conform to the 1996 presentation.

Disclosure of significant risks and uncertainties — The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE B — LONG-TERM DEBT

Water Services' long-term debt consisted of the following revenue bonds (amounts in millions):

Maturing In Fiscal Years	Effective Interest Rates	June 30, 1996	June 30, 1995
1996	3.6% - 7.8%	$ -	$ 14
1997 - 2001	3.6% - 7.8%	96	99
2002 - 2006	5.1% - 7.8%	139	147
2007 - 2011	5.1% - 7.5%	159	168
2012 - 2016	5.1% - 7.3%	157	166
2017 - 2021	5.3% - 7.3%	135	143
2022 - 2026	5.3% - 7.3%	103	109
2027 - 2031	5.3% - 7.1%	73	73
2032 - 2035	6.1% - 6.6%	17	17
Total principal amount		879	936
Unamortized premium and discount		(12)	(13)
Long-term debt due within one year		(14)	(14)
Total long-term debt and advance refunding bonds		$ 853	$ 909
Escrow funds available to call certain of the above bonds at scheduled crossover dates		$ 174	$ 217

Long-term debt outstanding at June 30, 1996 consisted of revenue bonds due serially in varying annual amounts through 2035. The revenue bonds generally are callable ten years after issuance. Scheduled annual principal maturities during the five years following June 30, 1996 are $14, $15, $19, $23 and $25 million, respectively. Revenue bonds are secured by the future revenues of Water Services. The Department has agreed to certain covenants with respect to bonded indebtedness, including the requirement that Water Services' net income, as defined, will be sufficient to pay certain amounts of future annual bond interest and of future annual aggregate bond interest and principal maturities.

During fiscal year 1996, bonds with a carrying value of $43 million were refunded from the balance in the escrow accounts. The remaining balance in the escrow accounts of $174 million will be used to refund bonds presently included in long-term debt with a carrying value of $170 million at scheduled crossover dates. The balance of $170 million of advance refunding bonds will be reclassified to long-term debt at the time that the bonds to be refunded are called. Interest expense and income for refunding bonds and related escrow accounts are included in Other Income and Expenses, Net.

NOTE C — SHARED OPERATING EXPENSES

Water Services shares certain administrative functions with the Department's Energy Services. Generally, the costs of these functions are allocated on the basis of the provided benefits.

Operating expenses shared with Energy Services were $501, $277 and $281 million for fiscal years 1996, 1995 and 1994, respectively, of which $162, $90 and $92 million were allocated to Water Services.

NOTE D — GAIN ON SALE OF LAND

In fiscal year 1996, Water Services realized a gain of $5 million on sale of excess land to unrelated party.

NOTE E — EMPLOYEE BENEFITS

RETIREMENT, DISABILITY AND DEATH BENEFIT INSURANCE PLAN — The Retirement Board of Administration is the administrator of the Water and Power Employees' Retirement, Disability and Death Benefit Insurance Plan which is subject to provisions of the Charter of the City of Los Angeles and the regulations and instructions of the Board of Water and Power Commissioners. The plan is considered an independent pension trust fund of the Department.

The Department has a funded contributory retirement, disability and death benefit insurance plan covering substantially all of its employees. Plan benefits are generally based on years of service, age at retirement and the employees' highest 12 consecutive months of salary before retirement. The Department funds the retirement plan on an entry age normal method as determined by the plan's independent actuary. For funding purposes, prior service costs relating to the plan are amortized over a 30-year period ending June 30, 2003. Total fiscal year benefit plan costs for Water Services include the following (amounts in millions):

	1996	1995	1994
Service cost	$ 16	$ 13	$ 14
Interest cost	77	55	54
Actual return on plan assets	(159)	(128)	(10)
Net amortization and deferral	86	83	(35)
Net retirement plan cost	20	23	23
Disability and death benefit plan costs and administrative expenses	4	3	3
Total benefit plan costs	$ 24	$ 26	$ 26

Of these costs, $5, $8 and $8 million were capitalized as Construction Work in Progress and the remainder, net of employee contributions, was charged to expense for fiscal years 1996, 1995, and 1994, respectively.

Employee contributions to the plan totaled $7, $6 and $5 million during fiscal years 1996, 1995 and 1994, respectively. Total covered payroll during fiscal years 1996, 1995 and 1994 was $132, $110 and $120 million, respectively.

The following schedule reconciles the funded status of the plan with amounts reported in the financial statements (amounts in millions):

	June 30, 1996	June 30, 1995
Actuarial present value of benefit obligations:		
Accumulated benefit obligation	$ 949	$ 659
Effect of projected future compensation level	160	125
Projected benefit obligation	1,109	784
Plan assets at fair value	1,175	794
Plan assets in excess of projected benefit obligation	(66)	(10)
Unrecognized prior service cost	(6)	(5)
Unrecognized net gain and effects of changes in assumptions	103	55
Unrecognized net obligation at July 1, 1987 being recognized over 15 years	(55)	(49)
Prepaid pension liability	$ (24)	$ (9)

The discount rate used in determining the plan's projected benefit obligation was 7.5% in both fiscal years 1996 and 1995. The assumed rate of increase in future compensation levels and the long-term rate of return on plan assets were 5.5% and 8.0%, respectively, in both fiscal years 1996 and 1995. Plan assets consist primarily of corporate and government bonds, common stocks, mortgage-backed securities and short-term investments.

HEALTH CARE COSTS — The Department provides certain health care benefits to active and retired employees and their dependents. The cost to Water Services of providing such benefits amounted to $29, $24 and $24 million for fiscal years 1996, 1995 and 1994, respectively. Of these costs, $7, $8 and $7 million were capitalized as Construction Work in Progress and the remainder was charged to expense for fiscal years 1996, 1995 and 1994, respectively. The total number of active and retired participants entitled to receive benefits was approximately 4,706 at June 30, 1996.

The Department accounts for post-retirement benefits based on Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," which requires that the cost of postretirement benefits be recognized as expense over employees' service periods. Water Services is amortizing its actuarially determined transition obligation related to prior service over 20 years. The effect of adopting this statement during fiscal year 1994 was an increase in reported Water Services expense of approximately $8 million. The total post-retirement benefit cost for fiscal years 1996 and 1995, included in health care benefits above, is summarized as follows (amounts in millions):

	1996	1995
Service cost	$ 2	$ 2
Interest cost	8	7
Amortization of transition obligation	4	4
	$ 14	$ 13

The accrued postretirement liability was as follows (amounts in millions):

	June 30, 1996	July 1, 1995
Accumulated postretirement benefit obligation (APBO):		
Active employees	$ 47	$ 42
Retirees and surviving spouses	65	44
	112	86
Plan assets at fair value	-	-
Unrecognized net gain	11	3
Unrecognized transition obligation	(69)	(73)
Accrued postretirement liability	$ 54	$ 16

The assumed health care cost trend rate was 5.5% per year for both fiscal years 1996 and 1995. Increasing the health care cost trend rate by one percentage point would increase the APBO as of June 30, 1996, by $15 million and periodic cost by $2 million. The discount rate used in determining the plan's accumulated postretirement benefit obligation was 7.5% in both fiscal years 1996 and 1995. There were no plan assets in fiscal year 1996 or 1995. The Department has not presently established a funding policy for the future benefits to be provided under this plan.

NOTE F — EARTHQUAKE DAMAGE

On January 17, 1994, a 6.7 magnitude earthquake centered in Northridge, California caused significant damage to Department facilities and major service interruption in the Water Services' territory. Cost estimates as of June 30, 1996 for capital replacements and improvements and repairs to Water Services facilities total approximately $47 million. Through June 30, 1996, Water Services has spent $21 million for repairing facilities damaged by the earthquake and charged $1, $1 and $3 million to expense during fiscal years 1996, 1995 and 1994, respectively. The Department has applied for reimbursement for a significant portion of the earthquake costs from the Federal Emergency Management Agency (FEMA). In addition to the property damage, service interruption and customer losses caused decreases in water consumption. The impact on net income as a result of these decreases in consumption cannot be readily determined.

NOTE G — COMMITMENTS AND CONTINGENCIES

TRANSFERS TO THE RESERVE FUND OF THE CITY OF LOS ANGELES — Under the provisions of the City Charter, Water Services transfers funds at its discretion to the reserve fund of the City of Los Angeles. Pursuant to covenants contained in the bond indentures, the transfers may not be in excess of net income of the prior fiscal year. Such payments are not in lieu of taxes and are recorded as distributions of retained income.

The Department made payments of approximately $26 million in fiscal year 1996 from Water Services to the reserve fund of the City of Los Angeles. This included an additional transfer of $6 million based on an authorization by the Board of Water and Power Commissioners in October 1994. The Department expects to make a transfer declaration of $21 million during fiscal year 1997.

WATER REGULATIONS — New regulations concerning filtration of surface water supplies will require increased commitment of resources by the Department. Major capital expenditures will be necessary to comply with the filtration requirements at open distribution reservoirs because of the State of California, Surface Water Treatment Rule (SWTR).

The Department has four major reservoirs subject to SWTR, which became effective in June 1993. Planning studies and discussions with local community representatives are ongoing to determine the system improvements necessary to bring these reservoirs into compliance. The Department has entered into an agreement with the State Department of Health Services that established a time schedule to come into compliance with the SWTR. Under the terms of this agreement, the four reservoirs are scheduled to be in compliance by 2003.

As of June 30, 1996, capital expenditures of approximately $30 million had been incurred which primarily related to preliminary engineering. The estimated total capital cost of the SWTR compliance program is approximately $425 million.

The above estimates were developed using currently mandated requirements and have been stated in 1996 dollars.

LITIGATION — A number of claims and suits are pending against the Department for alleged damages to persons and property and for other alleged liabilities arising out of its operations. In the opinion of management, any ultimate liability which may arise from these actions will not materially affect Water Services' financial position as of June 30, 1996.

RISK MANAGEMENT — Water Services is subject to certain business risks common to the utility industry. The majority of these risks are mitigated by external insurance coverage obtained by Water Services. For other significant business risks, however, Water Services has elected to self-insure. It is management's belief that exposure to loss arising out of self-insured business risks will not materially affect Water Services' financial position as of June 30, 1996.

NOTE H — FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Department in estimating the fair value at June 30, 1996 and 1995 of its financial instruments:

CASH AND INVESTMENTS — The carrying amount of cash and investments approximates fair value because of its short-term nature.

ESCROW ACCOUNTS — The fair value of investments included within the escrow accounts, which have a carrying value of $174 and $217 million at June 30, 1996 and 1995, respectively, is approximately $169 and $213 million, respectively. The fair value is based on quoted market prices.

LONG-TERM DEBT AND ADVANCE REFUNDING BONDS — The fair value of long-term debt and advance refunding bonds is approximately $750 and $174 million, respectively, at June 30, 1996, and $765 and $215 million, respectively, at June 30, 1995. Such estimates represent the present value of interest and principal payments on the long-term debt and advance refunding bonds discounted using current interest rates obtainable by the Department for debt of similar quality and maturities. The aggregate carrying amount of the long-term debt and advance refunding bonds, including the current portion, was $697 and $170 million, respectively, at June 30, 1996, and $708 and $215 million, respectively, at June 30, 1995.

REPORT OF INDEPENDENT ACCOUNTANTS

September 16, 1996

To the Board of Water and Power Commissioners
Department of Water and Power
City of Los Angeles

In our opinion, the accompanying balance sheet and the related statements of income, of retained income reinvested in the business and of cash flows present fairly, in all material respects, the financial position of Water Services of the Department of Water and Power of the City of Los Angeles at June 30, 1996 and 1995, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 1996, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Department's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

Simpson & Simpson

Los Angeles, California

ENERGY SERVICES BALANCE SHEET

(In Thousands)	June 30 1996	June 30 1995
ASSETS		
Utility Plant, at original cost		
Generation	$ 2,275,269	$ 2,256,699
Transmission	758,085	740,823
Distribution	3,020,680	2,893,654
General	761,913	749,428
	6,815,947	6,640,604
Less - Accumulated depreciation	2,418,937	2,209,090
	4,397,010	4,431,514
Construction work in progress	203,705	219,780
Nuclear fuel, at amortized cost	11,748	12,332
Net utility plant	4,612,463	4,663,626
Escrow Accounts - Advance refunding bonds	1,119,817	1,128,242
Nuclear Decommissioning Trust Funds	31,832	20,085
Current Assets		
Cash and investments	343,003	249,753
Customer and other accounts receivable, less $13,200 allowance for losses	195,801	193,431
Accrued unbilled revenue	106,477	110,364
Materials and supplies, at average cost	89,016	94,478
Fuel inventory	29,825	41,083
Prepayments and other current assets	66,606	46,280
Receivable from U.S. Government - FEMA	-	6,548
Total current assets	830,728	741,937
Total utility plant and assets	$ 6,594,840	$ 6,553,890
CAPITALIZATION AND LIABILITIES		
Capitalization		
Equity		
Retained income reinvested in the business	$ 2,017,075	$ 1,944,282
Contributions in aid of construction	225,261	215,328
	2,242,336	2,159,610
Long-term debt	2,622,327	2,691,433
Advance refunding bonds	1,112,469	1,117,226
Total capitalization	5,977,132	5,968,269
Current Liabilities		
Long-term debt due within one year	64,910	61,790
Revenue certificates payable	90,000	90,000
Accrued interest	66,525	68,592
Accounts payable and accrued expenses	216,481	229,792
Due to Water Services	17,665	21,535
Over-recovered energy costs	99,851	67,957
Deferred credit - Intermountain Power Agency	33,270	34,294
Transfer payable to the reserve fund of the City of Los Angeles	8,861	11,661
Advance from U.S. Government - FEMA	20,145	-
Total current liabilities	617,708	585,621
Commitments and Contingencies		
Total capitalization and liabilities	$ 6,594,840	$ 6,553,890

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

ENERGY SERVICES STATEMENT OF INCOME

(In Thousands)	1996	Year ended June 30 1995	1994
Operating Revenues			
Residential	$ 580,011	$ 591,176	$ 569,295
Commercial and industrial	1,275,843	1,275,970	1,272,106
Other	90,997	105,640	91,944
Total operating revenues	1,946,851	1,972,786	1,933,345
Operating Expenses			
Fuel for generation	151,039	239,005	261,898
Purchased power	707,938	659,612	608,393
Other operating expenses	353,820	459,873	448,459
Maintenance	188,955	156,431	169,649
Depreciation	231,847	203,758	191,999
Focused separation program	-	33,564	-
Total operating expenses	1,633,599	1,752,243	1,680,398
Operating Income	313,252	220,543	252,947
Other Income and Expenses, Net	24,161	21,816	18,919
Loss on Abandoned Projects	(28,694)	-	(20,045)
Income before debt expenses	308,719	242,359	251,821
Debt Expenses			
Interest on debt	181,200	186,225	189,892
Allowance for funds used during construction	(5,191)	(3,783)	(7,380)
Total debt expenses	176,009	182,442	182,512
Net Income	$ 132,710	$ 59,917	$ 69,309

STATEMENT OF RETAINED INCOME REINVESTED IN THE BUSINESS

(In Thousands)	1996	Year ended June 30 1995	1994
Balance at beginning of period	$ 1,944,282	$ 1,953,674	$ 2,060,249
Net income for the period	132,710	59,917	69,309
	2,076,992	2,013,591	2,129,558
Less - Transfers to the reserve fund of the City of Los Angeles	59,917	69,309	175,884
Balance at end of period	$ 2,017,075	$ 1,944,282	$ 1,953,674

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

ENERGY SERVICES STATEMENT OF CASH FLOWS

(In Thousands)	1996	Year ended June 30 1995	1994
Cash Flows From Operating Activities:			
Net income	$ 132,710	$ 59,917	$ 69,309
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	231,847	203,758	191,999
Amortization of nuclear fuel	6,792	7,698	5,880
Loss on abandoned projects	28,694	-	20,045
Allowance for funds used during construction	(5,191)	(3,783)	(7,380)
Provision for losses on customer and other accounts receivable	16,954	20,993	14,499
Changes in current assets and liabilities:			
Customer and other accounts receivable	(19,324)	(5,403)	(16,367)
Accrued unbilled revenue	3,887	(2,530)	1,815
Materials and supplies	5,462	19,632	(450)
Fuel inventory	11,258	33,041	26,620
Prepayments and other current assets	(17,873)	(28,358)	474
Accrued interest	(2,067)	(2,911)	12,817
Accounts payable and accrued expenses	(13,311)	(280)	5,365
Due to (from) Water Services	(3,870)	49	(16,418)
Over-recovered energy costs	31,894	9,992	34,211
Deferred credit - Intermountain Power Agency	(1,024)	(24,626)	(12,117)
Receivable/Advance from U.S. Government - FEMA	26,693	16,752	(23,300)
Net cash provided by operating activities	433,531	303,941	307,002
Cash Flows From Financing Activities:			
Sale of revenue bonds	-	-	207,938
Sale of advance refunding bonds	-	-	811,406
Amount deposited in escrow accounts related to advance refunding bonds	-	-	(812,104)
Amount received from escrow accounts, net	96,799	78,288	188,795
Contributions in aid of construction	9,933	24,493	24,295
Reduction of long-term debt	(65,986)	(55,247)	(56,912)
Long-term debt redeemed, including call premium	(95,584)	(75,552)	(188,795)
Transfers paid to the reserve fund of the City of Los Angeles	(62,717)	(131,648)	(101,884)
Net cash (used in) provided by financing activities	(117,555)	(159,666)	72,739
Cash Flows From Investing Activities:			
Additions to plant and equipment, net	(210,979)	(230,002)	(305,269)
Funding of nuclear decommissioning trust funds	(11,747)	(3,702)	(3,308)
Net cash used in investing activities	(222,726)	(233,704)	(308,577)
Cash and investments:			
Net increase (decrease)	93,250	(89,429)	71,164
Beginning of period	249,753	339,182	268,018
End of period	$ 343,003	$ 249,753	$ 339,182
Supplemental disclosure of cash flow information:			
Cash paid during the period for interest	$ 242,975	$ 249,111	$ 225,860

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

NOTE A — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

THE DEPARTMENT — The Department of Water and Power of the City of Los Angeles (the "Department") exists under and by virtue of the City Charter enacted in 1925 as a separate proprietary agency of the City. Energy Services is responsible for the generation, transmission and distribution of electric power for sale in the City.

METHOD OF ACCOUNTING — The accounting records of Energy Services are maintained in accordance with generally accepted accounting principles (GAAP) as prescribed by the Financial Accounting Standards Board (FASB) and, where applicable, the Governmental Accounting Standards Board (GASB). The accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission (FERC) and the California Public Utilities Commission (CPUC), except for the method of accounting for contributions in aid of construction described below.

The Department's rates are subject to review and approval by the City Council. As a regulated enterprise, the Department's financial statements are prepared based on the concepts of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS 71), which require that the effects of the ratemaking process be recorded in the financial statements. Such effects primarily concern the time at which various items enter into the determination of net income in order to follow the principle of matching costs and revenues. Accordingly, Energy Services records various regulatory assets and liabilities to reflect the regulator's actions. In August 1996, the State Legislature approved a bill to expand competition and deregulate electric generation (See Note B). Management continues to believe that Energy Services meets the criteria for continued application of SFAS 71, but will continue to evaluate changes in the regulatory and competitive environment to assess Energy Services' overall compliance with such criteria.

UTILITY PLANT — The costs of additions to utility plant and replacements of retired units of property are capitalized. Costs include labor, materials, an allowance for funds used during construction and allocated indirect charges such as engineering, supervision, transportation and construction equipment, retirement plan contributions, health care costs, and certain administrative and general expenses. The costs of repairs and minor replacements are charged to appropriate maintenance accounts. The original cost of property retired, plus removal cost, less salvage, is charged to accumulated depreciation.

DEPRECIATION — Depreciation expense is computed using the straight-line method for all projects completed after July 1, 1973 and for all office and shop structures, related furniture and equipment, and transportation and construction equipment. Depreciation for facilities completed prior to this date is computed using the 5% sinking fund method based on estimated service lives. Estimated service lives range from 5 to 75 years. Depreciation provision as a percentage of average depreciable utility plant in service was 3.7%, 3.4% and 3.4% for fiscal years 1996, 1995 and 1994, respectively.

NUCLEAR DECOMMISSIONING — Decommissioning of the Palo Verde Nuclear Generating Station, in which Energy Services has an ownership interest, is projected to start sometime after 2022. Based upon a study performed by an independent engineering firm, the Department's share of the estimated decommissioning costs is $82 million in 1995 dollars. Decommissioning costs are charged as part of depreciation expense over the life of the nuclear power plant. Decommissioning expense was $11, $3 and $3 million for fiscal years 1996, 1995 and 1994, respectively.

NUCLEAR FUEL — Nuclear fuel is amortized and charged to Fuel for Generation on the basis of actual thermal energy produced relative to total thermal energy expected to be produced over the life of the fuel. Under the provisions of the Nuclear Waste Policy Act of 1982, the federal government assumed responsibility for the future disposal of spent nuclear fuel and assesses each utility with nuclear operations $1 per MWH of nuclear generation to fund this future disposal.

ESCROW ACCOUNTS AND NUCLEAR DECOMMISSIONING TRUST FUNDS — Effective July 1, 1994, the Department adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities," which established new financial accounting and reporting standards for investments in debt and equity securities. Energy

Services' escrow accounts and nuclear decommissioning trust funds qualify under the definition of debt securities and are classified as held-to maturity. Escrow accounts are held in external trust funds to be used for calling revenue bonds at scheduled maturity dates. Nuclear decommissioning trust funds are also held in external trusts and will be used to pay the Department's share of decommissioning the Palo Verde Nuclear Generating Station at the end of its useful life. These investments are reported at amortized cost. The adoption of this statement did not have a material effect on the financial position or results of operations of Energy Services.

The proceeds received during fiscal year 1996 from the maturity of Energy Services' escrow investments were approximately $25 million.

CASH AND INVESTMENTS — The Department's cash is deposited with the City Treasurer who invests the funds in securities under the City Treasurer's pooled investment program. Under the program, available funds of the City and its independent operating departments are invested on a combined basis. These investments are valued at cost, which approximates market. At June 30, 1996 and 1995, cash and investments include $136 and $47 million, respectively, of internally designated balances relating to bond repayment funds, bond redemption and interest funds, a self-insurance fund, and a retiree health care cost fund. In addition, cash and investments at June 30, 1996 and 1995 include $33 and $34 million, respectively, relating to the energy cost adjustment stabilization account (Note F). The Department considers all cash investments with an original maturity of three months or less to be cash equivalents.

FUEL INVENTORY — Coal inventories are stated at average cost. Prior to June 30, 1996, fuel oil inventories are stated at cost, using the last-in, first-out method. In June 30, 1996, fuel oil inventories were valued at lower of cost or market.

CONTRIBUTIONS IN AID OF CONSTRUCTION — Under the provisions of the City Charter, amounts received from customers and others for constructing utility plant are combined with retained income reinvested in the business and represent equity for purposes of computing Energy Services' borrowing limits. Accordingly, contributions in aid of construction are shown in the accompanying balance sheet as an equity account and are not offset against utility plant.

REVENUES — Revenues consist of billings to customers for consumption of electric energy and include amounts resulting from an energy cost adjustment formula designed to permit the full recovery of energy costs, funding requirements of nuclear plant decommissioning costs, recovery of certain approved prepayments and the costs of funding certain conservation programs intended to reduce current and future energy consumption. The Department estimates these costs to establish the energy cost recovery component of customer billings and any difference between billed and actual costs, resulting in over- or under-recovery of such costs, is adjusted in subsequent billings.

Energy Services recognizes energy costs in the period incurred and accrues for estimated energy sold but not yet billed.

Energy Services' rates are established by a rate ordinance which is approved by the City Council. Energy Services sells electric energy to other City departments at rates provided in the ordinance.

DEBT EXPENSES — Debt premium, discount and issue expenses are deferred and amortized to expense over the lives of the related debt issues.

ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC) — AFUDC represents the cost of borrowed funds used for the construction of utility plant. Capitalized AFUDC is shown as part of the cost of utility plant and as a reduction of debt expenses. The average AFUDC rates were 6.0%, 6.0% and 6.6% for fiscal years 1996, 1995 and 1994, respectively.

RECLASSIFICATION — Certain financial statement items for fiscal years 1994 and 1995 have been reclassified to conform to the 1996 presentation.

DISCLOSURE OF SIGNIFICANT RISKS AND UNCERTAINTIES — The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE B — REGULATORY MATTERS

On August 31, 1996, the California State Legislature approved Bill AB 1890 (the "Bill") which provides for a broad restructuring of California's electric power industry. The Bill requires the participation of the State's three investor-owned utilities; publicly-owned utilities such as the Department are not ordered to participate in provisions of the Bill pertaining to retail deregulation and the Independent Systems Operator (see below); however, publicly-owned utilities are ordered to establish a non-bypassable usage-based charge on local distribution and to use the proceeds to fund public purpose programs at specified minimum levels.

The Bill provides for the following significant structural changes to California's electric power industry:

- A Power Exchange will be established to create a wholesale market for electric power. Participating utilities will be required to sell their power to the Power Exchange; the Power Exchange will sell power to utilities, marketers and consumers.
- An Independent Systems Operator ("ISO") will be established to manage the transmission assets of participating utilities; the ISO will be responsible for system scheduling, maintenance, repair and replacement standards for the transmission assets it controls. The ISO will also set tariffs to compensate owners for the use of their transmission assets.
- Customers will be provided the right to choose their power supplier based on a 5-year phase-in period beginning January 1, 1998 for IOUs and a 10-year phase-in period beginning January 1, 2000 for participating publicly-owned utilities; prior to transition, customers will continue to purchase power from their local utility company.
- A Competition Transmission Charge ("CTC") will be assessed to customers during the transition period to direct access. The CTC will be based on the amount necessary for the utility to recover the uneconomic costs of its generation assets subject to certain limitations and restrictions. Publicly-owned utilities must agree to comply with the provisions of the Bill relating to both direct access and the ISO to be eligible to collect the CTC.

The Bill requires that publicly-owned utilities such as the Department hold public hearings prior to deciding if they will participate in direct access. The Department must also consider and decide if it will join the ISO. Management is currently evaluating these and other issues relating to the Bill and expects to establish a process for responding to the Bill in the near future.

The implementation of this Bill will substantially alter the environment in which Energy Services operates. If the Department chooses to provide direct access pursuant to the Bill and to join the ISO, its current monopoly-based business will be fundamentally changed to a market environment. At this time, management is unable to predict the effect that this Bill will have on the operations of Energy Services.

Management is presently studying the Bill and the amount of its stranded investment. At this time, management has not completed its analysis of stranded investment; however, it is management's opinion that the amount of stranded investment is material and Energy Services' ability to recover its stranded investment will have a material impact on its future operations and its financial position overall.

NOTE C — JOINTLY-OWNED UTILITY PLANT

Energy Services has undivided interests in several electrical generating stations and transmission systems which are jointly-owned with other utilities. Each project participant is responsible for financing its share of construction and operating costs. The following schedule shows Energy Services' investment in each jointly-owned utility plant as included in the balance sheet at June 30, 1996 (dollar amounts in millions):

Projects	Ownership Interest	Share of Capacity (megawatts)	Plant in Service: Cost	Plant in Service: Accumulated Depreciation	Work In Progress
Palo Verde Nuclear Generating Station (Note K)	5.7%	217	$ 510	$ 112	$ 1
Navajo Generating Station	21.2%	477	197	112	49
Mohave Generating Station	20.0%	316	106	51	8
Pacific Intertie DC Transmission System	40.0%	1,240	190	35	6
Other transmission systems	Various		76	26	0
			$ 1,079	$ 336	$ 64

Energy Services will incur certain minimum operating costs on the jointly-owned facilities, regardless of the amount of energy generated or its ability to take delivery of its share of energy generated. Energy Services' proportionate share of the operating costs is included in the appropriate categories of operating expenses.

NOTE D — LONG TERM DEBT

Energy Services' long-term debt consisted of the following revenue bonds (amounts in millions):

Maturing In Fiscal Years	Effective Interest Rates	June 30, 1996	June 30, 1995
1996	3.5% - 9.2%	$ -	$ 62
1997 - 2001	3.6% - 7.8%	394	400
2002 - 2006	4.8% - 7.8%	556	557
2007 - 2011	4.8% - 7.8%	669	669
2012 - 2016	4.8% - 7.5%	647	647
2017 - 2021	4.8% - 7.5%	582	582
2022 - 2026	5.2% - 7.5%	519	520
2027 - 2031	5.2% - 7.5%	416	416
2032 - 2034	5.2% - 6.7%	58	58
Total principal amount		3,841	3,911
Unamortized premium and discount		(41)	(40)
Long-term debt due within one year		(65)	(62)
Total long-term debt and advance refunding bonds		$ 3,735	$ 3,809
Escrow funds available to call certain of the above bonds at scheduled crossover dates		$ 1,120	$ 1,128

Long-term debt outstanding at June 30, 1996 consisted of revenue bonds due serially in varying annual amounts through 2034. The revenue bonds generally are callable ten years after issuance. Scheduled annual principal maturities during the five years following June 30, 1996 are $65, $71, $78, $84 and $96 million, respectively. Revenue bonds are secured by the future revenues of Energy Services. The Department has agreed to certain covenants with respect to bonded indebtedness, including the requirement that Energy Services' net income, as defined, will be sufficient to pay certain amounts of future annual bond interest and of future annual aggregate bond interest and principal maturities.

During fiscal year 1996, bonds with a carrying value of $7 million were refunded from the balance in the escrow accounts. The remaining balance in the escrow accounts of $1,120 million will be used to refund bonds presently included in long-term debt with a carrying value of $1,100 million at scheduled crossover dates. The balance of $1,112 million of advance refunding bonds will be reclassified to long-term debt at the time that the bonds to be refunded are called. Interest expense and income for refunding bonds and related escrow accounts are included in Other Income and Expenses, Net.

NOTE E — REVENUE CERTIFICATES PAYABLE

At June 30, 1996 and 1995, the average interest rate of revenue certificates payable was 3.4% and 3.8% with various maturities of up to 121 and 104 days, respectively.

NOTE F — DEFERRED CREDIT - INTERMOUNTAIN POWER AGENCY

As of July 1, 1988, an amendment to an Intermountain Power Agency (IPA) bond resolution provided for the use of surplus construction funds from the Intermountain Power Project. As a member participant of this project, the Department's share of such surplus funds totaled $157 million through June 30, 1996.

Pursuant to a City Ordinance of January 2, 1991, the Department established an energy cost adjustment stabilization account. At the discretion of the Department's Chief Accounting Employee, funds may be transferred from this account to stabilize the energy cost adjustment factor portion of customer billings over a period not to exceed seven years. During fiscal year 1996, $1 million was transferred from this account and offset against purchased power expense, leaving a balance of $33 million in the energy cost adjustment stabilization account.

NOTE G — SHARED OPERATING EXPENSES

Energy Services shares certain administrative functions with the Department's Water Services. Generally, the costs of these functions are allocated on the basis of the provided benefits.

Operating expenses shared with Water Services were $501, $277 and $281 million for fiscal years 1996, 1995 and 1994, respectively, of which $339, $187 and $189 million were allocated to Energy Services.

NOTE H — EMPLOYEE BENEFITS

RETIREMENT, DISABILITY AND DEATH BENEFIT INSURANCE PLAN — The Retirement Board of Administration is the administrator of the Water and Power Employees' Retirement, Disability and Death Benefit Insurance Plan which is subject to provisions of the Charter of the City of Los Angeles and the regulations and instructions of the Board of Water and Power Commissioners. The plan is considered an independent pension trust fund of the Department.

The Department has a funded contributory retirement, disability and death benefit insurance plan covering substantially all of its employees. Plan benefits are generally based on years of service, age at retirement and the employees' highest 12 consecutive months of salary before retirement. The Department funds the retirement plan on an entry age normal method as determined by the plan's independent actuary. For funding purposes, prior service costs relating to the plan are amortized over a 30-year period ending June 30, 2003. Total fiscal year benefit plan costs for Energy Services include the following (amounts in millions):

	1996	1995	1994
Service cost	$ 35	$ 45	$ 48
Interest cost	180	185	182
Actual return on plan assets	(370)	(431)	(35)
Net amortization and deferral	201	277	(116)
Net retirement plan cost	46	76	79
Disability and death benefit plan costs and administrative expenses	8	11	11
Total benefit plan costs	$ 54	$ 87	$ 90

Of these costs, $13, $18 and $23 million were capitalized as Construction Work in Progress and the remainder, net of employee contributions, was charged to expense for fiscal years 1996, 1995, and 1994, respectively.

Employee contributions to the plan totaled $16, $18, and $18 million for fiscal years 1996, 1995 and 1994, respectively. Total covered payroll for each of the fiscal years 1996, 1995 and 1994 was $309, $370 and $390 million, respectively.

The following schedule reconciles the funded status of the plan with amounts reported in the financial statements (amounts in millions):

	June 30, 1996	June 30, 1995
Actuarial present value of benefit obligations:		
Accumulated benefit obligation	$ 2,212	$ 2,207
Effect of projected future compensation levels	373	418
Projected benefit obligation	2,585	2,625
Plan assets at fair value	2,740	2,658
Plan assets in excess of projected benefit obligation	(155)	(33)
Unrecognized prior service cost	(14)	(18)
Unrecognized net gain and effects of changes in assumptions	240	185
Unrecognized net obligation at July 1, 1987 being recognized over 15 years	(127)	(163)
Prepaid pension liability	$ (56)	$ (29)

The discount rate used in determining the plan's projected benefit obligation was 7.5% in both fiscal years 1996 and 1995. The assumed rate of increase in future compensation levels and the long-term rate of return on plan assets were 5.5% and 8.0%, respectively, in both fiscal years 1996 and 1995. Plan assets consist primarily of corporate and government bonds, common stocks, mortgage-backed securities and short-term investments.

HEALTH CARE COSTS — The Department provides certain health care benefits to active and retired employees and their dependents. The cost to Energy Services of providing such benefits amounted to $68, $80 and $79 million for fiscal years 1996, 1995 and 1994, respectively. Of these costs, $18, $17 and $21 million were capitalized as Construction Work in Progress and the remainder was charged to expense for fiscal years 1996, 1995 and 1994, respectively. The total number of active and retired participants entitled to receive benefits was approximately 10,981 at June 30, 1996.

The Department accounts for post-retirement benefits based on Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," which requires that the cost of postretirement benefits be recognized as expense over employees' service periods. Energy Services is amortizing its actuarially determined transition obligation related to prior service over 20 years. The effect of adopting this statement during fiscal year 1994 was an increase in reported Energy Services expense of approximately $25 million. The total postretirement benefit cost for fiscal years 1996 and 1995, included in health care benefits above, is summarized as follows (amounts in millions):

	1996	1995
Service cost	$ 7	$ 7
Interest cost	20	21
Amortization of transition obligation	14	14
	$ 41	$ 42

The accrued postretirement liability was as follows (amounts in millions):

	June 30, 1996	July 1, 1995
Accumulated postretirement benefit obligation (APBO):		
Active employees	$ 110	$ 138
Retirees and surviving spouses	152	148
	262	286
Plan assets at fair value	-	-
Unrecognized net gain	23	12
Unrecognized transition obligation	(230)	(244)
Accrued postretirement liability	$ 55	$ 54

The assumed health care cost trend rate was 5.5% per year for both fiscal years 1996 and 1995. Increasing the health care cost trend rate by one percentage point would increase the APBO as of June 30, 1996, by $35 million and periodic cost by $4 million. The discount rate used in determining the plan's accumulated postretirement benefit obligation was 7.5% in both fiscal years 1996 and 1995. There were no plan assets in fiscal year 1996 or 1995. The Department has not presently established a funding policy for the future benefits to be provided under this plan.

NOTE I — LOSS ON ABANDONED PROJECTS

In fiscal year 1996 and 1994, management formally abandoned several projects and reported a loss on abandonment of $29 million and $20 million, respectively. The projects abandoned in 1996 were White Pine Power Project, a planned coal-fired generating plant in Ely, Nevada for which a $13 million loss was recorded; Utah-Nevada Transmission line for which a $9 million loss was recorded and several construction projects in the Los Angeles basin amounting to a loss of $7 million.

The project abandoned in 1994 was the Coso Geothermal Project. The resulting write off of $20 million relates to costs incurred for the drilling and testing of three deep exploratory wells to determine whether a viable geothermal resource for generating electricity exists.

NOTE J — EARTHQUAKE DAMAGE

On January 17, 1994, a 6.7 magnitude earthquake centered in Northridge, California caused significant damage to Department facilities and major service interruption in the Energy Services' territory. Cost estimates as of June 30, 1996 for capital replacements and improvements and repairs to Energy Services' facilities total approximately $161 million. Through June 30, 1996, Energy Services has spent $65 million for repairing facilities damaged by the earthquake and charged $2, $2 and $3 million to expense during fiscal years 1996, 1995 and 1994, respectively. The Department has applied for reimbursement for a significant portion of the earthquake costs from the Federal Emergency Management Agency (FEMA). In addition to the property damage, service interruption and customer losses caused decreases in power consumption. The impact on net income as a result of these decreases in consumption cannot be readily determined.

NOTE K — COMMITMENTS AND CONTINGENCIES

TRANSFERS TO THE RESERVE FUND OF THE CITY OF LOS ANGELES — Under the provisions of the City Charter, Energy Services transfers funds at its discretion to the reserve fund of the City of Los Angeles. Pursuant to covenants contained in the bond indentures, the transfers may not be in excess of net income of the prior fiscal year. Such payments are not in lieu of taxes and are recorded as distributions of retained income.

The Department made payments of approximately $63 million in fiscal year 1996 from Energy Services to the reserve fund of the City of Los Angeles. This included an additional transfer of $3 million based on an authorization by the Board of Water and Power Commissioners in June 1994. The Department expects to make a transfer declaration of $97 million during fiscal year 1997.

LONG-TERM PURCHASED POWER AND TRANSMISSION CONTRACTS — The Department has entered into a number of energy and transmission service contracts which involve substantial commitments. These include an agreement with the Intermountain Power Agency, a Utah State Agency, for purchase of energy from the Intermountain Power Project (IPP) for which Energy Services has served as the project manager and operating agent. The Department has a 66.8% total entitlement in IPP's electrical output comprised of 48.6% "take or pay" obligations and a contract to purchase power of up to 18.2% of electric output. The Department also has four agreements with the Southern California Public Power Authority (SCPPA), a California Joint Powers Agency: 67% of SCPPA's 5.9% entitlement to the energy generated at the Palo Verde Nuclear Generating Station, 59.5% of the capacity of the Southern Transmission System, which transmits energy from IPP in Utah to Southern California, 35.7% and 24.8% "take or pay" basis interest in the Mead-Adelanto and Mead-Phoenix Projects, respectively. Significant data related to these agreements at June 30, 1996, which are scheduled to expire from 2022 to 2030, are as follows:

	Total Bonds Outstanding (millions)	Department Share of Capacity (megawatts)
Palo Verde Nuclear Generating Station (through SCPPA)	$ 1,007	151
Mead-Adelanto Project (through SCPPA)	268	291
Mead-Phoenix Project (through SCPPA)	86	148
Intermountain Power Project	4,183	1,068
Southern Transmission System (for IPP power through SCPPA)	1,393	1,142

The above agreements require Energy Services to make certain minimum payments, which are based mainly upon debt service requirements. While these payments are fixed charges (approximately $330 million in each of the next five years), the Department is also required to pay additional amounts (approximately $130 million in each of the next five years) for operating and maintenance costs related to actual deliveries of energy under these agreements. Total payments under these agreements were approximately $550, $540 and $500 million in fiscal years 1996, 1995 and 1994, respectively. These aggregate purchased power costs are recovered through the energy cost recovery component of customer billings.

The Department also has a contract through 2017 with the U.S. Department of Energy for the purchase of available energy generated at the Hoover Power Plant. The Department's share of capacity at Hoover is approximately 500 megawatts. The cost of power purchased under this contract was $11, $12 and $13 million in fiscal years 1996, 1995 and 1994, respectively.

PALO VERDE NUCLEAR GENERATING STATION — The Price-Anderson Act (the "Act") requires that all utilities with nuclear generating facilities share in payment for claims resulting from a nuclear incident. The Act limits liability from third-party claims to $8.9 billion per incident. Participants in the Palo Verde Nuclear Generating Station currently insure potential claims and liability through commercial insurance with a $200 million limit; the remainder of the potential liability is covered by the retrospective assessment program provided under the Act.

ENVIRONMENTAL MATTERS — Numerous environmental laws and regulations affect Energy Services' facilities and operations. Pursuant to regulations of the South Coast Air Quality Management District in Southern California, Energy Services is committed to annual reductions in emission limits of its generating stations in the Los Angeles Basin until the final limit is reached in 2003. Compliance with the annual limits will be accomplished through retrofitting nitrogen oxide controls on generating units and/or purchasing Regional Clean Air Incentive Market (RECLAIM) trading credits from the marketplace.

As of June 30, 1996, capital expenditures of approximately $80 million have been incurred to retrofit units at the Haynes and Scattergood Generating Stations. These retrofit pollution controls will achieve compliance with emission limits through year 2001. Additional controls at an estimated cost of $20 to $40 million may be needed after year 2001 to achieve the final limit of year 2003.

The above estimates were developed using currently mandated Clean Air Act requirements and have been stated in 1996 dollars.

LITIGATION — A number of claims and suits are pending against the Department for alleged damages to persons and property and for other alleged liabilities arising out of its operations. In the opinion of management, any ultimate liability which may arise from these actions will not materially affect the Energy Services' financial position as of June 30, 1996.

RISK MANAGEMENT — Energy Services is subject to certain business risks common to the utility industry. The majority of these risks are mitigated by external insurance coverage obtained by Energy Services. For other significant business risks, however, Energy Services has elected to self-insure. It is management's belief that exposure to loss arising out of self-insured business risks will not materially affect the Energy Services' financial position as of June 30, 1996.

NOTE L — FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Department in estimating the fair value at June 30, 1996 and 1995 of its financial instruments:

CASH AND INVESTMENTS — The carrying amount of cash and investments (excluding the nuclear decommissioning trust funds) approximates fair value because of its short-term nature.

NUCLEAR DECOMMISSIONING TRUST FUNDS — The fair value of investments included within the nuclear decommissioning trust funds, approximates the carrying value of $32 and $20 million at June 30, 1996 and 1995, respectively. The fair value is based on quoted market prices.

ESCROW ACCOUNTS — The fair value of investments included within the escrow accounts, which have a carrying value of $1,120 and $1,128 million at June 30, 1996 and 1995, respectively, is approximately $1,090 and $1,108 million, respectively. The fair value is based on quoted market prices.

LONG-TERM DEBT AND ADVANCE REFUNDING BONDS — The fair value of long-term debt and advance refunding bonds is approximately $2,800 and $1,100 million, respectively, at June 30, 1996, and $2,870 and $1,100 million, respectively, at June 30, 1995. Such estimates represent the present value of interest and principal payments on the long-term debt and advance refunding bonds discounted using current interest rates obtainable by the Department for debt of similar quality and maturities. The aggregate carrying amount of the long-term debt and advance refunding bonds, including the current portion, was $2,687 and $1,112 million, respectively, at June 30, 1996, and $2,753 and $1,117 million, respectively, at June 30, 1995.

REVENUE CERTIFICATES PAYABLE — The carrying amount of revenue certificates payable approximates fair value because of its short-term nature.

REPORT OF INDEPENDENT ACCOUNTANTS

September 16, 1996

To the Board of Water and Power Commissioners
Department of Water and Power
City of Los Angeles

In our opinion, the accompanying balance sheet and the related statements of income, of retained income reinvested in the business and of cash flows present fairly, in all material respects, the financial position of Energy Services of the Department of Water and Power of the City of Los Angeles at June 30, 1996 and 1995, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 1996, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Department's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

Simpson & Simpson

Los Angeles, California

WATER SERVICES SELECTED FINANCIAL DATA AND STATISTICS

($ Millions)	1996	1995	1994	1993	1992
Statement of Income					
Operating revenues					
Residential	$ 166.6	$ 150.8	$ 163.6	$ 141.6	$ 122.1
Commercial and industrial	230.5	228.6	237.7	229.9	183.3
Governmental and other	25.8	25.5	29.3	38.4	36.8
Total revenues	$ 422.9	$ 404.9	$ 430.6	$ 409.9	$ 342.2
Operating income	151.9	93.5	100.5	92.7	66.4
As % of revenues	35.9%	23.1%	23.3%	22.6%	19.4%
Net Income	$ 119.9	$ 54.1	$ 59.9	$ 64.1	$ 51.6
Balance Sheet					
Net utility plant	$ 1,890.0	$ 1,795.0	$ 1,709.7	$ 1,631.6	$ 1,566.3
Capital additions, net	152.6	140.4	130.3	111.7	175.8
Capitalization					
Equity	1,305.2	1,183.8	1,153.5	1,102.6	1,044.8
Long-term debt	682.4	693.9	608.4	622.1	566.8
Advance refunding bonds	170.2	215.5	215.1	79.5	—
Total capitalization	2,157.8	2,093.2	1,977.0	1,804.2	1,611.6
Debt as % of net utility plant (A)	36.1%	38.7%	35.6%	38.1%	36.2%
Interest on debt	48.4	46.8	44.0	45.3	37.3
Transfers to City of L.A.	20.2	40.0	20.5	17.1	17.4
Operations					
Gallons sold (billions)	190.6	179.1	178.1	176.0	166.6
Customers — average number (thousands)	642.1	638.2	638.4	643.5	647.9
Average revenue per hundred cu. ft. sold (in cents)					
Residential	175.0	173.0	187.0	164.7	154.8
Commercial and industrial	176.6	170.1	177.3	171.8	141.5
Water supply (billions of gallons)					
Local supply	25.2	32.9	10.1	19.9	30.5
DWP Aqueduct	151.0	83.3	69.5	75.9	57.5
Metropolitan Water District	21.5	75.0	116.4	94.2	95.1
Gross supply	197.7	191.2	196.0	190.0	183.1
Diversion from (to) local storage	0.9	(2.0)	1.2	0.5	(1.2)
Net supply to distribution systems	198.6	189.2	197.2	190.5	181.9

(A) Excludes revenue notes and advance refunding bonds

ENERGY SERVICES SELECTED FINANCIAL DATA AND STATISTICS

($ Millions)	1996	1995	1994	1993	1992
Statement of Income					
Operating revenues					
Residential	$ 580.0	$ 591.2	$ 569.3	$ 602.6	$ 535.5
Commercial and industrial	1,275.9	1,276.0	1,272.1	1,334.3	1,231.6
Street lighting and other	54.0	65.0	56.1	64.0	38.3
Miscellaneous	37.0	40.6	35.8	36.8	23.7
Total revenues	$ 1,946.9	$ 1,972.8	$ 1,933.3	$ 2,037.7	$ 1,829.1
Operating income	313.3	220.5	252.9	319.5	195.4
As % of revenues	16.1%	11.2%	13.1%	15.7%	10.7%
Net Income	$ 132.7	$ 59.9	$ 69.3	$ 176.1	$ 74.2
Balance Sheet					
Net utility plant	$ 4,612.5	$ 4,663.6	$ 4,641.3	$ 4,546.6	$ 4,295.5
Capital additions, net	211.0	230.0	305.3	415.9	462.7
Capitalization					
Equity	2,242.3	2,159.6	2,144.5	2,226.8	2,119.5
Long-term debt	2,622.3	2,691.5	2,750.2	2,599.9	2,333.8
Advance refunding bonds	1,112.5	1,117.2	1,145.0	522.4	—
Total capitalization	5,977.1	5,968.3	6,039.7	5,349.1	4,453.3
Debt as % of net utility plant [(A)]	56.9%	57.7%	59.3%	57.2%	54.3%
Interest on debt	181.2	186.2	189.9	173.8	156.5
Transfers to City of L.A.	59.9	69.3	175.9	74.2	90.6
Operations					
Kilowatt hours sold (billions)	22.2	21.7	21.2	22.5	21.7
Customers — average number (thousands)	1,350.8	1,338.5	1,349.4	1,360.6	1,362.8
Average revenue per kWh sold (in cents)					
Residential	9.6	9.9	9.8	9.7	9.0
Commercial and industrial	8.6	9.0	8.9	8.8	8.1
Energy production (billion kWh)					
Hydro	1.6	0.9	1.0	1.0	0.9
Thermal	9.1	13.2	12.7	13.2	12.3
Total generation	10.7	14.1	13.7	14.2	13.2
Purchases	14.5	10.8	11.1	12.2	12.0
Total production	25.2	24.9	24.8	26.4	25.2
Net system capability (thousand megawatts)					
Hydro	1.5	1.4	1.4	1.4	1.4
Thermal	3.2	3.0	3.0	3.0	3.0
	4.7	4.4	4.4	4.4	4.4
Jointly-owned and firm purchases	2.9	2.9	2.9	2.9	3.1
	7.6	7.3	7.3	7.3	7.5

(A) Excludes revenue notes and advance refunding bonds

WATER SERVICES FACTS IN BRIEF

	Year ended June 30 1996	1995
Use of Water		
Average Los Angeles population served	3,664,100	3,653,000
Average daily use per capita (gallons)	142.1	134.3
Water sales for fiscal year (billion gallons)	190.6	179.1
Maximum daily demand (million gallons)	759.4	719.4
Water Supply (in billions of gallons)		
Local supply (groundwater)	25.2	32.9
Los Angeles Aqueduct (Owens Valley)	151.0	83.3
Metropolitan Water District (California and Colorado River Aqueducts)	21.5	75.0
Gross supply	197.7	191.2
Diversion from (to) local storage	0.9	(2.0)
Net supply to distribution systems	198.6	189.2

ENERGY SERVICES FACTS IN BRIEF

	Year ended June 30 1996	1995
Number of Customers		
Residential	1,157,100	1,149,000
Commercial	174,200	170,000
Industrial	16,600	16,600
All others	2,900	2,900
Total customers of all classes	1,350,800	1,338,500
Power Use		
Sales to ultimate customers – kilowatt (kW) hours	21,223,475,000	20,513,244,000
Sales to other utilities – kW hours	1,020,601,000	1,235,046,000
Average annual kW hours per residential customer	5,234	5,178
Net dependable capacity, kilowatts	6,900,000	7,252,000

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