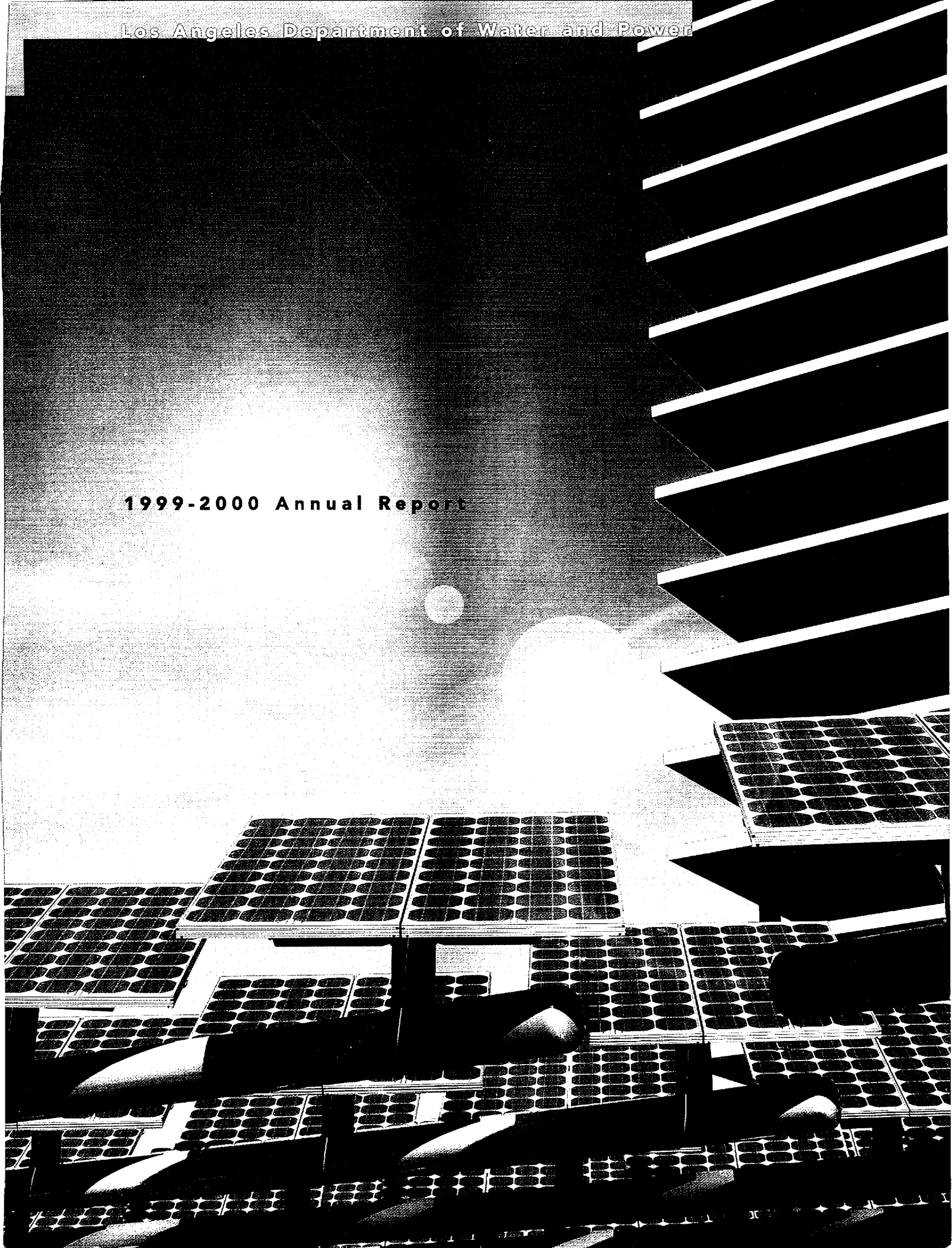
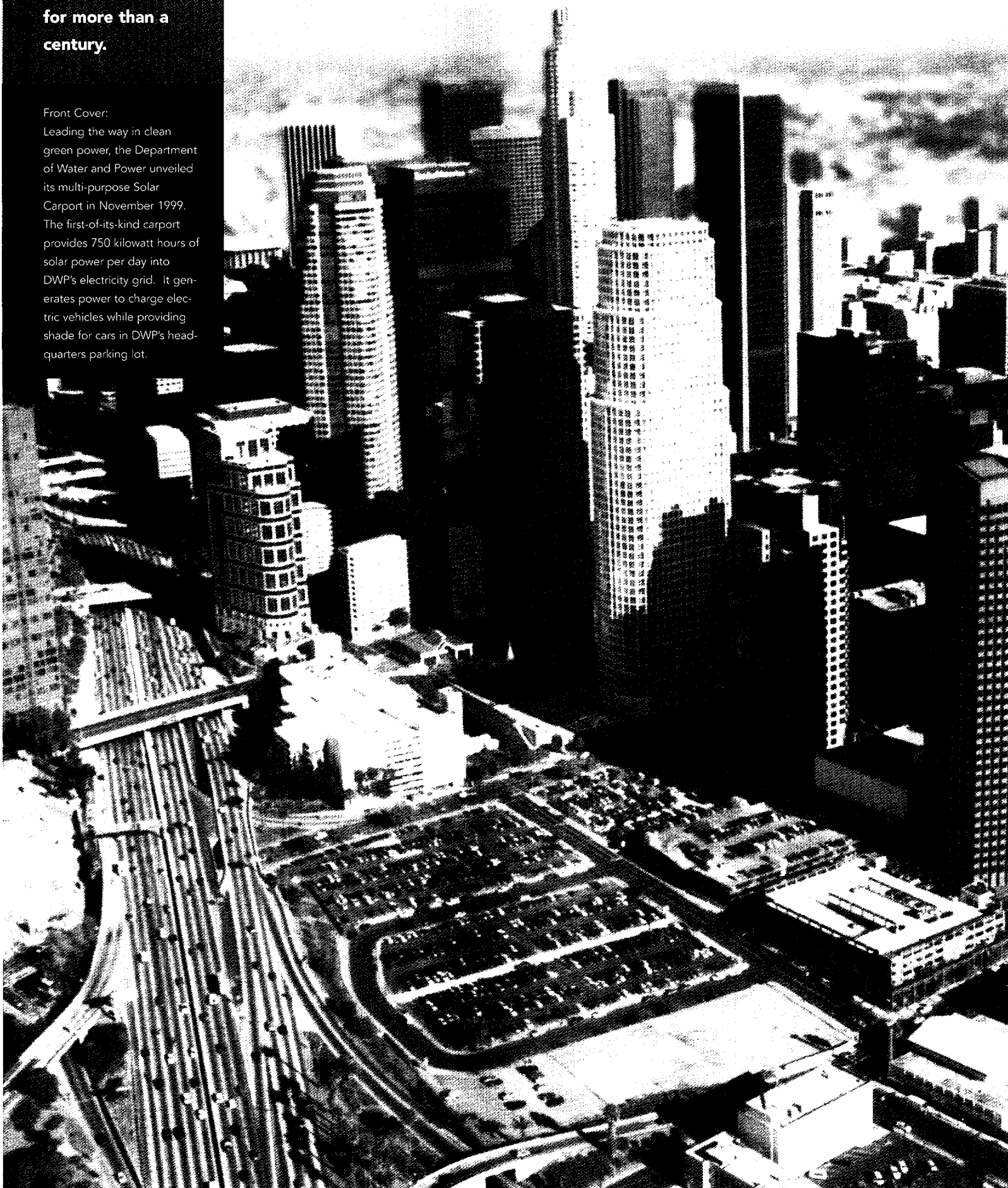



1999-2000 Annual Report



**The Los Angeles
Department of
Water and Power
has served the City
for more than a
century.**

Front Cover:
Leading the way in clean
green power, the Department
of Water and Power unveiled
its multi-purpose Solar
Carport in November 1999.
The first-of-its-kind carport
provides 750 kilowatt hours of
solar power per day into
DWP's electricity grid. It gen-
erates power to charge elec-
tric vehicles while providing
shade for cars in DWP's head-
quarters parking lot.





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**Board
President's
Message**

With firm financial footing, an aggressive business plan and a clear vision for the future, the Los Angeles Department of Water and Power (DWP) has never been in a better position to continue its important job of filling the water and electric needs of the city's 3.8 million people.

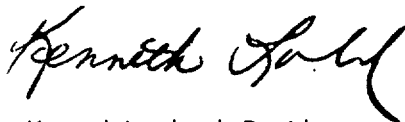
Just three years ago, the future of DWP, the nation's largest municipal utility, was at risk. Deregulation in California was looming, and DWP faced the difficult **task of reducing its massive \$4.1 billion** generation debt, downsizing its workforce, and heightening the level of service to customers – all in order to survive a competitive market.

With an aggressive plan and swift action, this utility set its course and made great progress on many fronts. **DWP is now on schedule** to be free of generation debt on our existing facilities by 2003; the staff and the management teams have been reorganized; and the emphasis on customer service has never been greater in the history of this organization.

Making steady progress, DWP has epitomized the successful public power utility in a deregulated arena. This was particularly evident this summer, as the uncertainties of a changing electricity market sent prices escalating to record levels for many Californians. Yet, while a majority of the state faced severe power shortages and steep rate hikes, **DWP and its customers enjoyed a surplus** of electricity, among the lowest residential rates in Southern California.

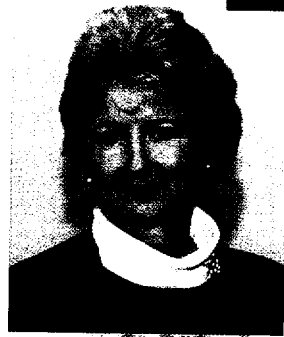
The volatility of the energy market tested the wisdom of DWP's strategy and, most importantly, **confirmed that the correct course of action** had been taken. DWP never waived from its core mission: to deliver a reliable and safe water and electric supply to the businesses and residents of the City of Los Angeles.

This is an exciting time for the Department and we look forward to continuing to serve you well into the future.



Kenneth Lombard, President

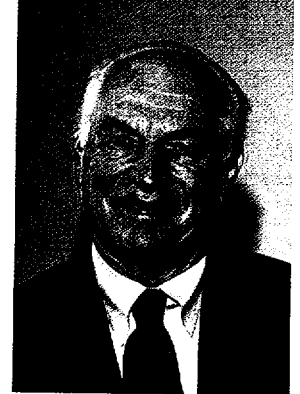
Judy M. Miller
Vice President



Rick Caruso
Commissioner



Michael Keston
Commissioner



Dominick W. Rubalcava
Commissioner



City of Los Angeles

Richard J. Riordan
Mayor of Los Angeles

John Ferraro
President, City Council
Councilmember, Fourth District

Mike Hernandez
Councilmember, First District

Joel Wachs
Councilmember, Second District

Laura Chick
Councilmember, Third District

Michael Feuer
Councilmember, Fifth District

Ruth Galanter
Councilmember, Sixth District

Alex Padilla
Councilmember, Seventh District

Mark Ridley-Thomas
Councilmember, Eighth District

Rita Walters
Councilmember, Ninth District

Nate Holden
Councilmember, Tenth District

Cindy Miscikowski
Councilmember, Eleventh District

Hal Bernson
Councilmember, Twelfth District

Jackie Goldberg
Councilmember, Thirteenth District

Nick Pacheco
Councilmember, Fourteenth District

Rudy Svorinich, Jr.
Councilmember, Fifteenth District

James K. Hahn
City Attorney

Rick Tuttle
Controller

Over the last year, the Los Angeles Department of Water and Power (DWP) has demonstrated why we feel that the Department is not only the nation's largest municipal utility, but also **the nation's model public utility**. We have not veered from the course we set to achieve financial stability; we have not swerved from the path we chose to meet the competitive electricity marketplace head-on; and we have not strayed from the route we selected to become a responsive, customer-oriented public utility. And our unwavering commitment to these ends has led to a thriving DWP.

The Department achieved important milestones over the past fiscal year. We have:

- **Reduced the utility's generation debt** by more than half – from \$4.1 billion in 1997 to less than \$1.8 billion in June of 2000, putting DWP well on its way to eliminating this debt on existing facilities by 2003;
- Expanded the revenue garnered from the wholesale trading area — resulting in **net revenue of \$125 million** this fiscal year;
- **Transferred a \$134 million "dividend"** to the City of Los Angeles to support vital city services;
- Signed long-term contracts with 28 top commercial and industrial customers that will **secure more than \$1 billion** in revenue over the lifetime of the agreements; and
- Maintained an **Aa3 credit rating** from Moody's Investors Services.

Although these accomplishments bring us great pride, it is our vision for Los Angeles' future and our enumerated plan to realize those needs that should earn us the confidence of our customers.

Over the past year, in its efforts to prepare for the future, DWP has accomplished:

- The development of the DWP 2000 Integrated Resource Plan which subsequently was approved by the Board of Water and Power Commission and Los Angeles City Council. This 10-year power expansion plan focuses on **improving reliability, lowering prices** for customers and **addressing environmental concerns**.
- Preparation to update the DWP Urban Water Management Plan – which describes the Department's efforts to **continue promoting efficient water use** and management of its water resources, while outlining strategies to meet Los Angeles' current and future water needs.
- The remarkable growth and expansion of our Green Power for a Green LA program – **a model renewable energy program** that replaces electricity from polluting power plants with energy generated from renewable resources such as sun, wind, and water.
- A smooth, successful Year 2000 technology rollover, culminating three years of preparation, which has left the Department **more efficient, able to meet** future technological challenges, and better prepared to mitigate unforeseen future crises.

- The continuation of **our protective stewardship** of the Owens Valley region, the wellspring of more than 50 percent of Los Angeles' water supply, highlighted by the awarding of a contract to provide needed restoration of the lake to new levels and dust relief to the Owens Lake region.
- Preservation of the largest open space in Los Angeles at the Chatsworth Reservoir, saving it for future generations.

Over the years, many have doubted DWP's ability to transform itself into a lean, efficient utility, ready to successfully compete in the deregulated energy marketplace. We have demonstrated what we can do through our achievements. Now, with our eyes focused on the future needs of our customers, we are **aggressively fulfilling our obligation** to deliver electricity and water services at the most competitive rates, while preserving the environment in the process.

The Department is anxious to build upon the work that we have already begun in transforming DWP into the national public utility to which all others are compared.

A handwritten signature in black ink, reading "S. David Freeman". The signature is fluid and cursive, with the first name "S. David" and last name "Freeman" clearly distinguishable.

S. David Freeman, General Manager

Preparing for the Future

The Los Angeles Department of Water and Power (DWP), **the nation's largest municipal utility**, has **an almost** 100-year history of delivering water and electricity services to the residents of Los Angeles. **During** this time, the City of Los Angeles has literally transformed from a sleepy desert town to the thriving metropolis it is today – thanks in part to the availability of the essential services provided by DWP. Today, Los Angeles' growth continues, and so too must we expand our responsibility in order to meet the higher demands.

Our organization spent much of this fiscal year planning for the future delivery of water and power to this city. We sought **new and innovative ways** to provide our services. We carefully examined how to meet an increased electricity demand with a limited amount of new generation sources; we considered alternative means of energy production with less environmental impact; we explored ways to maximize the water available to us in this desert we know as Los Angeles; we considered innovative water recycling projects; and we dedicated thousands of hours to ensuring that the Y2K bug did not bite Los Angeles.

Following are just a few of the ways DWP is planning for Los Angeles' future:

2000 Integrated Resource Plan

As the City of Los Angeles grows, so too does the demand for, and consumption of, electricity. Foresight and careful planning are required to meet the increasing electricity needs, and so this year DWP introduced its 2000 Integrated Resource Plan to meet this challenge.

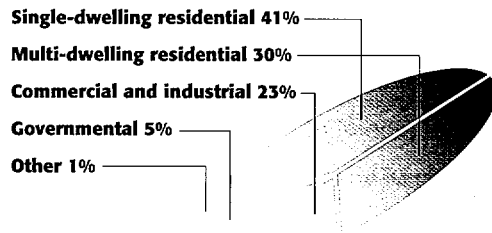
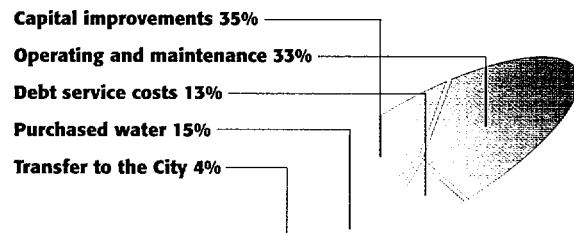
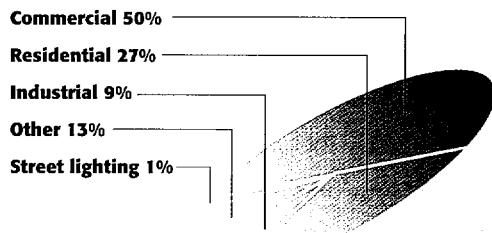
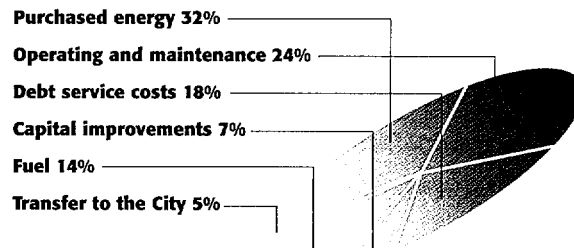
Under this plan, within a few years, DWP will be able to provide the electrical needs of Los Angeles for the foreseeable future with reliable and cleaner power.

DWP's Resource Plan is a sweeping, 10-year power expansion which calls for a \$1.7 billion capital investment to finance 2,900 megawatts of repowered in-basin generation, renewable resources of energy and demand side management programs. The plan is rooted in **improving reliability, lowering prices** for customers and realizing positive environmental benefits.

Central to the plan's focus on electric reliability is the repowering of Los Angeles basin power facilities at Valley, Haynes and Scattergood Generating Stations. A total of 10 units will be modernized with new, highly-efficient combined natural gas facilities with state-of-the-art emission controls. In addition, generating electricity locally reduces the risk of power loss through congested transmission lines and other outages.

Under the Resource Plan, DWP will also add approximately 300 megawatts of combustion turbines (CTs) to its facilities that will allow the Department to **meet "super peak" periods** at a moment's notice. CTs can be turned on for just a few hours a day during hot summer months, a benefit over traditional power plants that must be on for several hours before generating any electricity.

Continued on page 8

Water Revenue**Water Expenditures****Energy Revenue****Energy Expenditures****Comparative Highlights**

Year ended June 30

SERVICE

Sales

Customers — average number
(thousands)

FINANCIAL

Revenue ^(A)

Operating Costs ^(B)

Net Income

Transfers to City of
Los Angeles

Capital additions, net

Net utility plant

Capitalization — equity and
long-term debt ^(C)

| | WATER | | | ENERGY | | |
|--|---------------------|----------|--------------------------|----------------------------|------------|--------------------------|
| | 2000 | 1999 | % Increase (Decrease) | 2000 | 1999 | % Increase (Decrease) |
| | GALLONS IN BILLIONS | | | KILOWATT HOURS IN BILLIONS | | |
| Sales | 202.8 | 192.0 | 5.6% | 22.2 | 26.2 | -15.3% |
| Customers — average number (thousands) | 647.0 | 645.0 | 0.3% | 1,433.0 | 1,386.0 | 3.4% |
| | IN MILLIONS | | | IN MILLIONS | | |
| Revenue ^(A) | \$ 520.2 | \$ 439.4 | 18.4% | \$ 2,421.7 | \$ 2,261.0 | 7.1% |
| Operating Costs ^(B) | 283.0 | 240.1 | 17.9% | 1,581.7 | 1,531.9 | 3.3% |
| Net Income | 120.0 | 94.1 | 27.5% | 402.1 | 312.1 | 28.8% |
| Transfers to City of Los Angeles | 22.2 | 16.3 | 36.2% | 112.0 | 108.1 | 3.6% |
| Capital additions, net | 206.5 | 155.6 | 32.7% | 148.1 | 145.5 | 1.8% |
| Net utility plant | 2,314.7 | 2,177.5 | 6.3% | 4,241.6 | 4,355.6 | -2.6% |
| Capitalization — equity and long-term debt ^(C) | 2,364.7 | 2,173.7 | 8.8% | 6,449.0 | 5,385.5 | 19.7% |

(A) Includes other income and expenses-net (B) Excludes depreciation expense (C) Excludes advance refunding bonds

Top Right: At Broadway and Second Street, one of Los Angeles' first electric cable cars provides modern transportation for city residents in 1905. In that year, William Mulholland began extensive planning for construction of the Los Angeles Owens River Aqueduct after voters approved a \$1.5 million bond issue to acquire water rights.

Bottom Right: DWP's water is consistently tested to meet stringent standards and ensure the highest water quality possible.



And finally, under this plan, DWP will sell its 20-percent share of the Mohave Generating Station in Southern Nevada, a 30-year-old coal-burning power plant. The sale of Mohave will earn DWP \$190 million, plus \$75 million saved in pollution controls, which will be used to fund the new Los Angeles basin generating facilities. Unless the buyer waives its rights, completion of this transaction is subject to closing of the buyer's purchase of Southern California Edison's 56 percent ownership interest in Mohave, which is pending final regulatory approval.

Urban Water Management Plan

Providing a reliable water supply for a growing population in the middle of a desert is a challenge for which DWP is prepared. After all, we have nearly 100 years of experience.

Even in 1902, with a population of slightly more than 100,000, water use efficiency was the guiding principle for DWP's management of the city's water resources. Today that principle remains in place as DWP continues its **commitment to water use efficiency** while providing a safe, reliable and affordable water supply to city residents.

This fiscal year, DWP began preparations to formally update its Urban Water Management Plan which describes the utility's efforts to continue promoting efficient water use and management of its water resources, while outlining strategies to meet Los Angeles' current and future water needs.

With increasing demands for imported water supplies, DWP, along with all of the water agencies in Southern California, is faced with the challenge of providing a reliable water supply for a growing population. In the form of the Urban Water Management Plan, DWP has detailed its specific plans to continue meeting the water needs of Los Angeles.

The plan's highlights include:

- Pursuing cost-effective water conservation and recycling projects to increase supply reliability and offset increases in water demand due to growth;
- Protecting existing groundwater supplies from contamination and providing treatment to optimize their use;
- Ensuring continued reliability of city water supplies from the Metropolitan Water District (MWD) through active representation;
- Maintaining the operational integrity of the Los Angeles Aqueduct and in-city water distribution systems; and
- Securing needed funds to develop alternative supplies, such as conservation and recycling projects, and resource management programs.

Collectively, these actions allow DWP to fulfill its mission, *"to deliver a dependable supply of safe, quality water to our customers in an efficient and publicly responsible manner."*

Green Power One-Year Anniversary

Launched in May 1999, DWP's Green Power for a Green LA program has emerged as one of the **model renewable energy programs** in the country. Today, more than 47,000 Los Angeles residents and businesses have opted to purchase a portion of their electricity from renewable sources such as sun, wind, water and biomass.

Customers are assessed a monthly fee of about \$3, or roughly 6 percent of the average \$50 monthly household electric bill. This fee is offset through free efficiency products provided by DWP to the customer upon enrollment in the program.

DWP's Green Power program not only offers Angelenos cleaner air, but is designed to be an economic development catalyst to the City. The program has already attracted manufacturers of renewable energy sources to Los Angeles.

Moreover, in June 2000, DWP's Green Power Program **earned a top national ranking** from the National Renewable Energy Lab, an affiliate of the United States Department of Energy who named it, *"one of the country's top ten utility renewable energy programs."*

Y2K Preparation

After more than three years of preparation and tremendous employee dedication, the Department achieved a smooth, successful 2000 rollover in which the Y2K "bug" was noticeably absent. DWP's Year 2000 Project team was assembled in the summer of 1996 to ensure that water and electric service continued uninterrupted during the transition to January 1, 2000 – a goal that was met and exceeded. In the course of successfully guiding the Department into the year 2000, the Y2K team replaced obsolete telecommunication and computer equipment with faster, more efficient devices. These upgrades will enable the Department to meet future technological challenges and reduce DWP operating expenses. Additionally, the Y2K Project preparation **strengthens the Department's ability to respond** to unforeseen future crises. Recognizing at the onset of this project that failure was not an option, the Y2K team met industry standards and best practices set forth by the North American Reliability Council, the Electric Power and Research Institute, and national organizations recognized for establishing engineering standards of electricity in North America. Additionally, DWP met our institutional client and Department bond and financial reporting requirements and had its mission-critical systems "ready" by June 30, 1999. The roll-over happened without incident.

**Energy Services
Activities
Ensuring Reliability**

Since its creation nearly 100 years ago, DWP has made low-cost power and reliability its policy cornerstone. The Department is dedicated to providing an **uninterrupted supply of power** to the city's 3.8 million businesses and residents. DWP has also demonstrated its good-neighbor policy of selling excess power to the state to ensure power gets to the communities outside of the City of Los Angeles when they need it most. Here are some of the energy services highlights from the past year:

Long-Term Customer Contract Signing Celebration

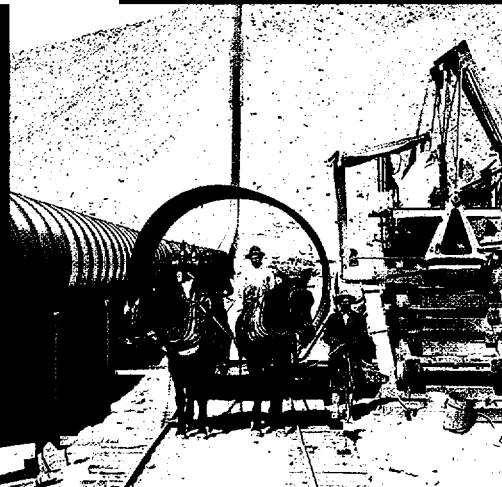
Well on the road to fiscal strength in 1999, DWP embarked on a marketing program to secure some of its largest revenue-producing clients to **long-term contracts**. Signing these 28 customers is part of the Department's business plan to ensure a healthy revenue stream, should the Los Angeles City Council vote to open its doors to retail electricity competition.

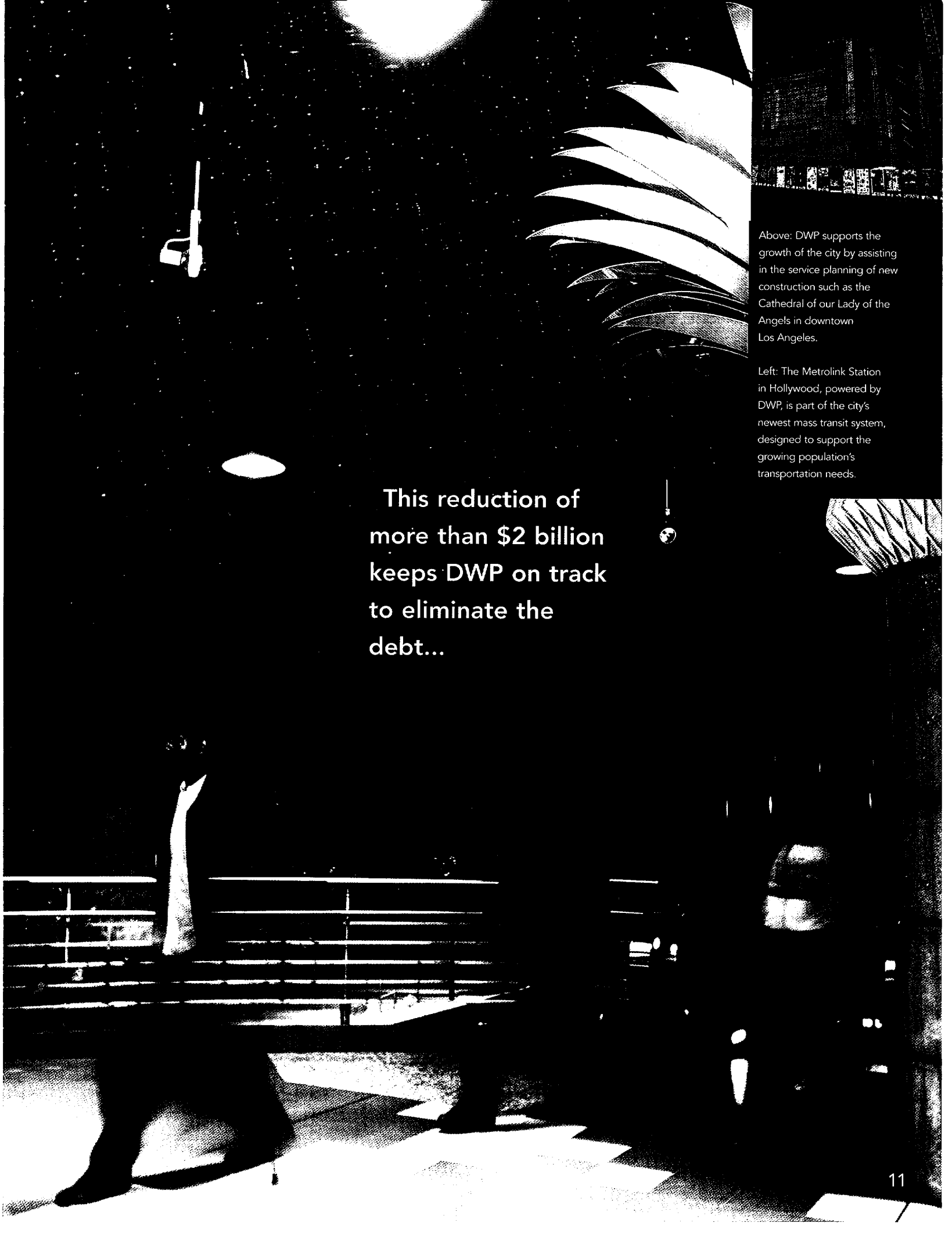
In recognition of their commitment to DWP, in November 1999 the Department gathered city leaders at a reception to thank these companies for their business and their vote of confidence in DWP. This event, *"A Celebration of Our Customers,"* was held at the Getty House, the Mayor's official residence in Hancock Park. City leaders including Mayor Richard Riordan, City Council President John Ferraro, City Councilmember Ruth Galanter and others joined David Freeman to say *"thank you"* to these top customers. Represented at the event were some of the city's most prominent businesses, including the J. Paul Getty Center, McDonalds, Home Depot, and the Kaiser Foundation, among others. Together these customers account for approximately \$100 million in annual revenue for the DWP and represent, over the life of the contracts, revenue to DWP totaling nearly \$1 billion.

Debt Reduction Celebration

In May 2000, DWP announced that its **generation debt had been reduced** from \$4.1 billion in 1997 to \$1.9 billion as of April 30, 2000. This reduction of more than \$2 billion keeps DWP on track to eliminate the debt on existing facilities by 2003, the date outlined in the DWP's Action Plan. The event, held at its downtown headquarters, was

Riveted steel pipe used to construct sections of the original Los Angeles Aqueduct traveled by ship around Cape Horn and then by railroad before finally being hauled into place by mules through dozens of Mojave Desert canyons crossed by the aqueduct route.





This reduction of
more than \$2 billion
keeps DWP on track
to eliminate the
debt...

Above: DWP supports the growth of the city by assisting in the service planning of new construction such as the Cathedral of our Lady of the Angels in downtown Los Angeles.

Left: The Metrolink Station in Hollywood, powered by DWP, is part of the city's newest mass transit system, designed to support the growing population's transportation needs.

attended by DWP General Manager S. David Freeman, Board of Water and Power Commissioner Rick Caruso, and Los Angeles City Council-member Ruth Galanter, who chairs the Council's Commerce, Energy and Natural Resources Committee which oversees the DWP. Held to honor the employees at DWP and to celebrate their crucial role in the debt reduction achievement, the event culminated with the unveiling of an oversized electronic countdown billboard entitled, "DWP: Debt Free in '03." Based on current forecasts, the billboard tracks funds available to retire this debt at nearly \$2 million per day. This sign currently can be viewed counting down the debt in the lobby of the DWP headquarters in downtown L.A.

Deregulation vs. Public Power

California's experiment with deregulation overheated customers' tempers throughout the state during the summer of 2000. Californians felt the pain of the state's 1996 power deregulation in their pocketbooks, homes and businesses. California Governor Gray Davis put state offices on drastic power diets, as did the federal government. Emergency town hall meetings were called with business owners and customers by investor-owned utilities as they tried to respond to consumer calls for reregulation.

However, DWP's customers **successfully avoided the electrical problems** that plagued the rest of the state – skyrocketing electric bills and selective service interruptions. As *The Los Angeles Times* said, "By standing pat during a time of massive change in the electricity business – a move that could easily have backfired – the DWP has emerged as one of the state's strongest players." DWP earned high marks for reliability and low rates.

In fact, DWP sold extra capacity into the open market during time of peak demand. In contrast to the investor-owned utilities that quit building power plants in the face of deregulation, DWP in 1998 revamped three dormant power plants that are now producing an extra 960 megawatts. Today, DWP can produce more than 7,000 megawatts per day, while demand for power in the city, even during heat waves this year, never topped 5,700 megawatts per day. These strategic moves kept the lights and air conditioning on in Los Angeles, and sales of extra capacity, excess energy and excess transmission capacity netted the Department more than \$126 million in operating income from wholesale activity this year.

- Los Angeles Unified School District
- McDonald's Corporation
- St. Vincent Medical Center
- Equitable Life Assurance Company
- Robinsons May
- Kaiser Foundation Health Plan, Inc.
- Northridge Hospital (Roscoe Blvd. Campus)
- Northridge Hospital (Sherman Way Campus)
- George Rice & Sons
- Anheuser-Busch Inc.
- Matchmaster Inc.
- Antex Knitting Mills
- United Signature Foods LLC
- GTE Communication Systems Corporation and Affiliates
- Diagnostic Products Corporation
- State Fish Company Inc.
- Rocketdyne Division of Boeing North America
- Home Depot USA Inc.
- White Memorial Medical Group
- Westvaco-US Envelope
- Macy's West Inc.
- J. Paul Getty Center
- David Young Lee
- Department of Public Works
- University of Southern California
- Los Angeles World Airport
- Limited Inc.
- Albertsons Inc.

Maintaining Reliability

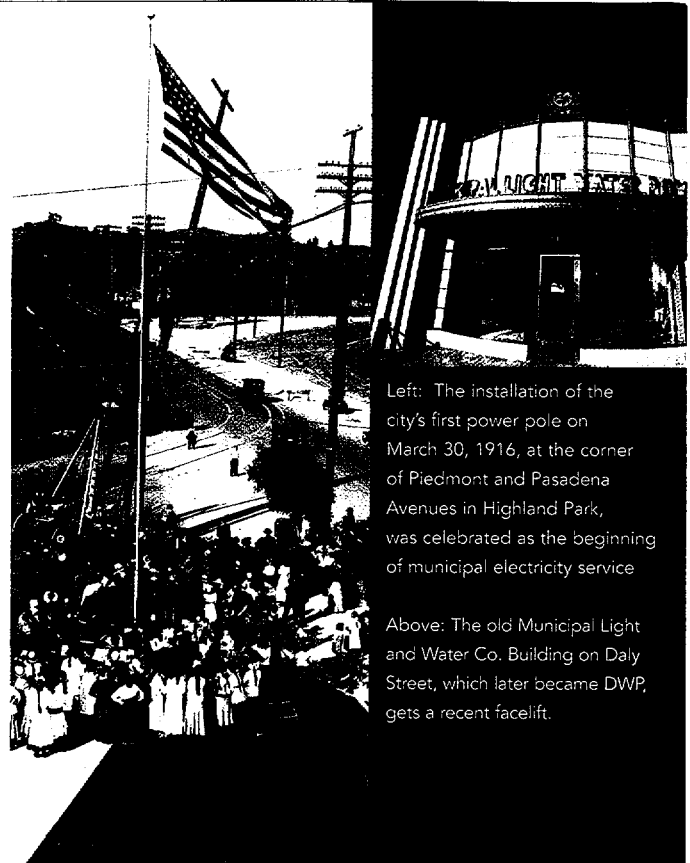
To monitor the performance and reliability of the power network, DWP uses industry-adopted indicators such as the System Average Interruption Duration Index (SAIDI) and the System Average Interruption Frequency Index (SAIFI). DWP has been in **the top 10 percent** of all utilities included in the SAIDI and SAIFI indices in providing excellent reliability to its customers. In fact, during fiscal year 1999-2000, the number of outages on DWP's system decreased by 35 percent compared to fiscal year 1997-1998. During this period, the average duration of an outage also decreased. The following two programs have also contributed to DWP's success in maintaining reliability of electric services:

Tree Trimming Program

DWP has an aggressive tree trimming program to clear the power lines of trees and limbs that cause outages by coming in contact with the lines. The trees are trimmed according to the International Society of Arboriculture (ISA) and the American National Standards Institute (ANSI) 300 pruning guidelines. In February 1999, DWP began tree-trimming in one-year cycles to maintain adequate clearance between the power lines and the trees. Approximately 189,000 trees were trimmed during fiscal year 1999-2000.

Distribution System Inspections

With the goal of preventing problems from becoming outages, DWP has increased the number of inspections of the distribution system to find and repair potential sources of outages. DWP began a program in July 1999 to conduct detailed inspections of its 44,000 underground infrastructures every two and a half years. By the end of the fiscal year, more than 18,000 inspections were done. Infrared equipment is used to check for the presence of hot spots in the underground switchgear and transformers. DWP plans to use this technology to inspect the entire power system every four years. The Department has also dedicated a crew to perform annual visual inspections of the overhead lines and equipment. This includes 280,000 poles, more than 100,000 overhead transformers and 6,067 pole line miles.



Left: The installation of the city's first power pole on March 30, 1916, at the corner of Piedmont and Pasadena Avenues in Highland Park, was celebrated as the beginning of municipal electricity service


Above: The old Municipal Light and Water Co. Building on Daly Street, which later became DWP, gets a recent facelift.

Water Services Activities – Ensuring a Consistent Water Supply for the Future

The DWP takes its water supply mission very seriously – “to deliver a dependable supply of safe, quality water to our customers in an efficient and publicly responsible manner.” Here are some of the important steps DWP is taking to ensure this mission will be met for future generations of Angelenos:

Water Supply

The Los Angeles Aqueducts, local groundwater, and the Metropolitan Water District of Southern California continue to be the primary suppliers of water to the city. However, water is a scarce resource in Southern California because we live in a desert, and numerous court decisions have limited the amount of water DWP can import from other regions. We must continue to **find more ways to stretch the water** we are already using. As the City of Los Angeles continues its remarkable growth, we are taking into consideration the needs of future generations and making long-term plans, using creative solutions, to meet the increasing water needs of our residents, businesses and industries.

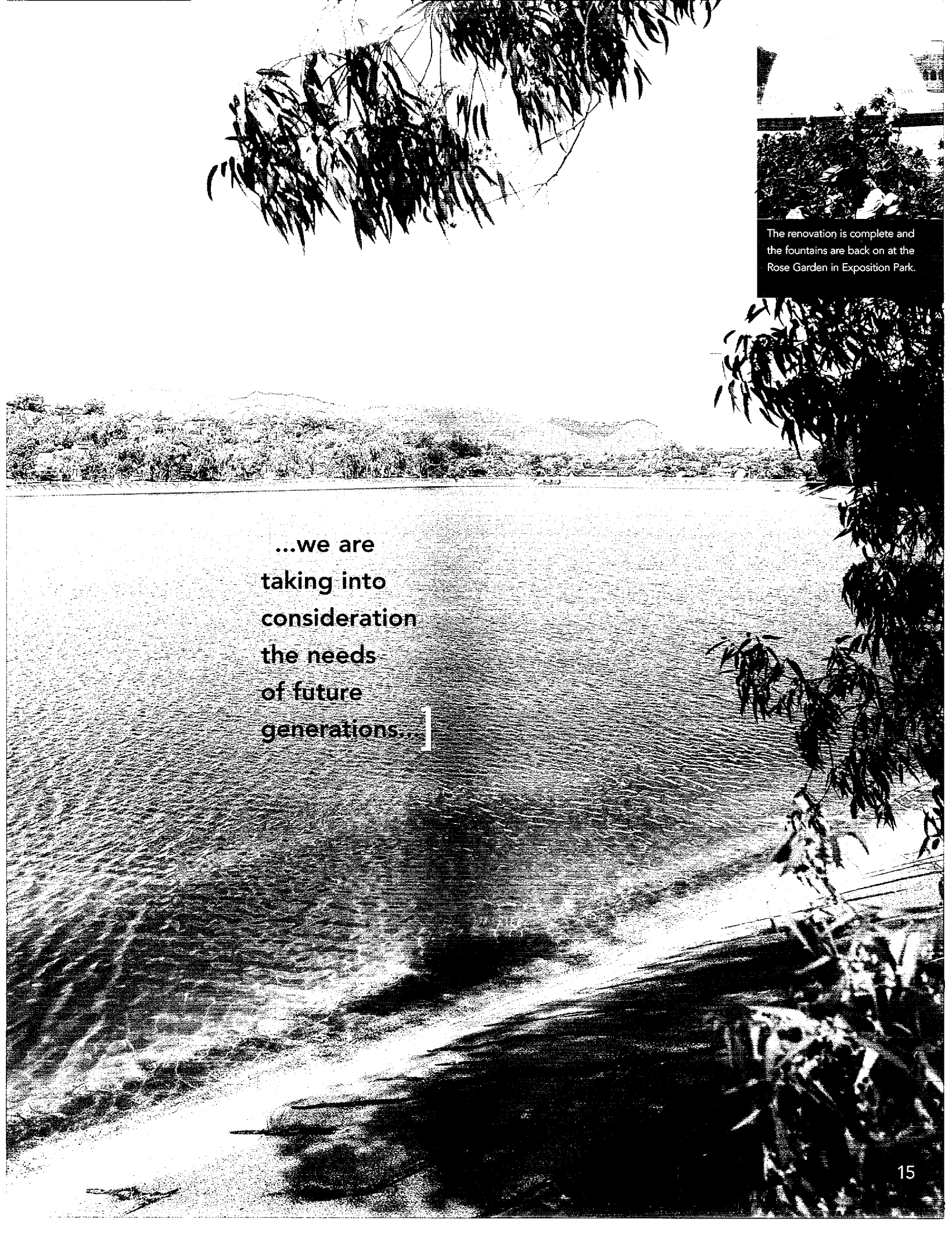


On November 5, 1913, a crowd of 20,000 witnessed the arrival of the first Owens River water through the Los Angeles Aqueduct at the Cascades in northern San Fernando Valley. Aqueduct builder William Mulholland exclaimed, “There it is, take it,” as the water rushed down the concrete channel.

Water Conservation

Los Angeles takes a tremendous amount of pride in its water conservation accomplishments, and continues to lead the way in implementing demand-reduction programs. As the city’s primary agent for implementing such programs, DWP has on behalf of its customers, become **a statewide and national leader** by investing more than \$100 million in conservation measures over the last decade. The City will maintain this same level of commitment well into the new century with investments that are at least equal to those of the last 10 years.

The DWP is leading the way in water conservation **by providing incentives** to residential customers for installing water efficient toilets and washing machines, and to commercial customers for replacing inefficient water-using equipment. DWP contin-



The renovation is complete and
the fountains are back on at the
Rose Garden in Exposition Park.

...we are
taking into
consideration
the needs
of future
generations...

ues to provide conservation information to our customers and support conservation-focused educational programs. Some of these educational programs reach children at the elementary and secondary school levels, while others come in the form of technical assistance and landscape irrigation expos.

Despite the fact that water demand slowly has been increasing since the end of water rationing in 1992, Angelenos continue to consistently conserve water. Conservation has had a tremendous impact on Los Angeles' water use patterns, and has become a permanent element of DWP's water management philosophy.

East Valley Water Recycling Project

Recycling water improves the overall reliability of the Los Angeles water supply by **reducing the city's dependency** on water from imported sources. In 1989, the City of Los Angeles adopted water reuse goals.

Today, the DWP is recycling more than 41,000 acre-feet (AF) per year. Currently the treated water is being used for irrigation, industrial and recreational purposes. By 2020 the city's total recycled water use is expected to increase to more than 250,000 AF. An extensive wastewater treatment process including tertiary treatment and disinfection is used for all recycled water.

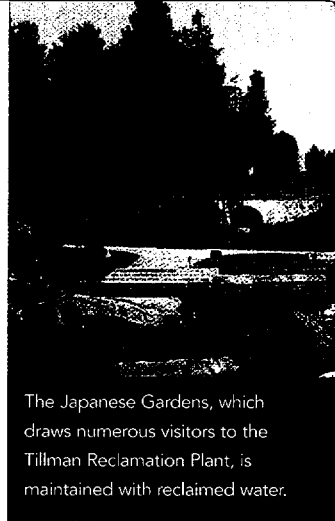
The city's first effort to recharge groundwater supplies with recycled water, the East Valley Water Recycling Project, was completed. When operational, the project will provide the city with additional groundwater for municipal uses, including drinking water. The city is required to **demonstrate that water quality standards** and safety requirements are being met at each stage of the project. As the extracted water must meet all applicable water standards, the East Valley project was conservatively constructed, with safeguards that are 10 times tougher than the standards required by the California Department of Health Services. When industrial and irrigation customers are added in later stages, total production from the East Valley Project will be 35,000 AF per year. Additional water reclamation projects support the Balboa Lake recreational facility, Wildlife Lake for wildlife habitat, the authentic 6.5 acre Japanese Gardens at the Sepulveda Dam recreation area and the Los Angeles Greenbelt Project.

Desalination Technology

Over 97 percent of the world's water is found in the ocean; however, seawater cannot be used for drinking or most other purposes without the aid of desalination processes, which remove the salt and other impurities from water. Most of the world's desalting plants are located in regions

of the world where no other fresh water supplies are available. Nationally, desalinated seawater is generally not part of the traditional water supply portfolio.

Though current high costs act as a deterrent to usage, desalinated water from the Pacific Ocean may factor into the city's future water supply needs. Continued technological improvements may make this an affordable resource in upcoming decades. Further, diminishment of supply, coexistent with strong demand, may also strengthen the desirability of this resource as a future option.



The Japanese Gardens, which draws numerous visitors to the Tillman Reclamation Plant, is maintained with reclaimed water.



The City of Los Angeles makes wise use of water resources by using reclaimed water to keep parks, golf courses and other grassy areas green.

DWP is very proud of its performance fulfilling its first duty of providing its customers with safe and reliable water and energy service. The additional, yet important, role that the Department has assumed to **help create a healthier environment** is one which DWP is very committed. The initiatives launched by the Green LA program over the last year reflect this commitment. Here are some examples:

Solar Program Update

As the "sunshine city," Los Angeles is the ideal locale to pursue solar electric programs. DWP has launched several new solar power initiatives over the past year that offer environmental benefits of replacing electricity from polluting power plants with energy generated from a clean, renewable resource. Pursuing a solar program benefits the city by providing a new source of jobs and economic development.

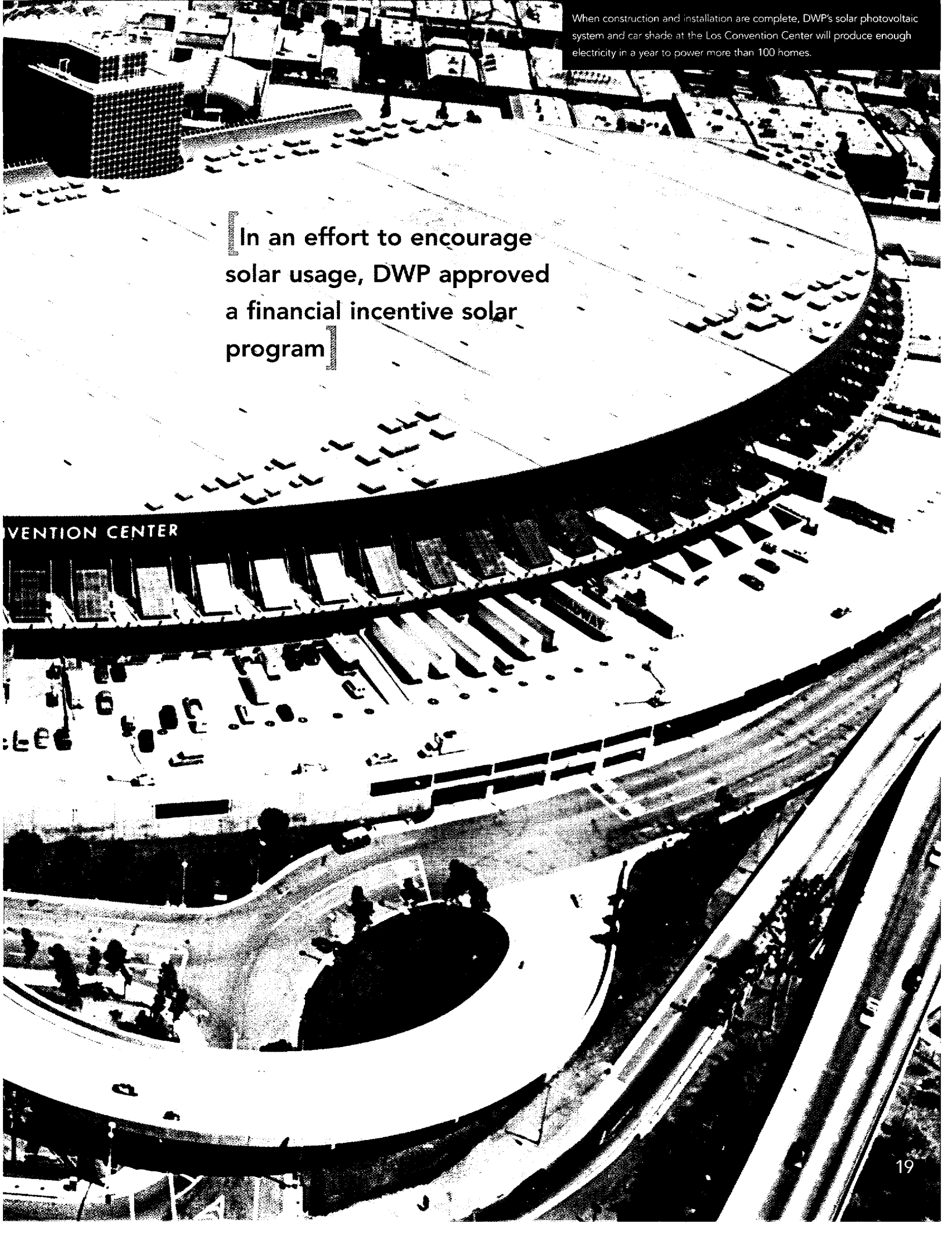
Financial Incentives Offered To Residents and Businesses – In an effort to encourage solar usage by its customers, in June 2000 the Los Angeles Board of Water and Power Commissioners approved the first year of a **multi-year financial incentives** solar program. This program provides up-front financial incentives designed to encourage DWP's residential, commercial, and industrial customers to install solar photovoltaic systems that generate electricity without producing air or noise pollution by reimbursing customers a portion of the purchase cost of the solar panel system.

The new incentive program is offered to qualified homeowners and businesses that purchase and install their own photovoltaic systems. This project will offset the customer's electricity cost, on average, by 50 percent. Additionally, by increasing the market for solar products and manufacturing incentives, Los Angeles will grow more attractive to solar companies that are seeking locations for their factories.

\$6 Million Investment – In June 2000, DWP announced that it awarded AstroPower a \$6 million contract to supply solar electric power modules to the city. The contract represents the first phase of an ambitious four-year program to provide clean and affordable solar power to DWP customers, which lowers pollution in the L.A. basin and improves the electric system reliability.



Roof tops are the new sites of "mini power plants" in Los Angeles and residential customers take advantage of DWP's incentive program to install solar photovoltaic systems that generate clean electricity.

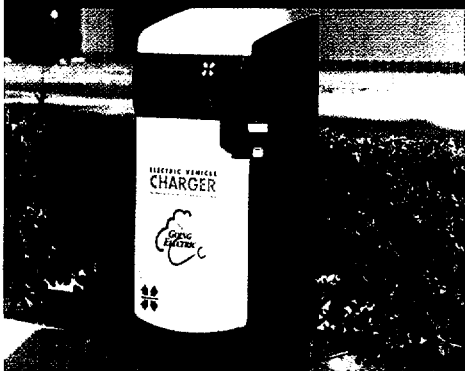
An aerial photograph of the Los Convention Center, a large, curved building with a white roof. The roof is covered with a grid of solar panels. The building is surrounded by parking lots, roads, and other urban structures. The text is overlaid on the top right of the image.

When construction and installation are complete, DWP's solar photovoltaic system and car shade at the Los Convention Center will produce enough electricity in a year to power more than 100 homes.

■ In an effort to encourage solar usage, DWP approved a financial incentive solar program ■

VENTION CENTER

Los Angeles continues to set trends with its long-time support of clean, electric transportation. DWP has installed or upgraded nearly 400 free charging stations throughout the city for drivers of electric vehicles.



Rapid Electric Vehicle Charging Station

In November 1999, DWP debuted a first-of-its-kind Solar Carport to power a rapid charging station for a wide variety of electric vehicles, including the city's first door-to-door airport electric shuttle service. The carport will provide 750 kilowatt hours of solar power per day directly to into DWP's electricity grid – the equivalent of powering 30 homes in Los Angeles. This multi-purpose structure also provides shade for cars at the DWP headquarters' parking lot.

The electric vehicle rapid charging station powers vehicles up to 10 times faster than traditional technologies, thereby making electric vehicles more practical and convenient to use. This precedent-setting project allows a vehicle to be charged in a matter of minutes rather than hours. It was developed through a partnership between DWP, AeroVironment, and DaimlerChrysler, and stands as a prime example of economic opportunities that await California, if it continues to invest in renewable energy and energy efficiency technologies that reduce emissions of greenhouse gases.

On the day of the carport's debut, California State Senator Byron Sher, chair of the California Senate Environmental Quality Committee stated, "DWP's commitment to green power is an object lesson for the rest of California."

Solar Showcase – DWP's solar panels were proudly displayed to the world as they powered the 2000 Democratic National Convention (DNC). Permanently attached to the Los Angeles Convention Center, the **photovoltaic cells made their debut** by supplying more than 15 percent of the power required for the lights, cameras and action of the convention.

The 2000 DNC was the greenest political convention in history. DWP supplied enough Green Power from wind and other sources through the DWP power grid to power the entire convention. Combined with the Department's loan of electric buses and the convention's focus on recycling, the DNC proclaimed the convention a landmark and showcase for solar power.

The photovoltaic solar power system will continue to provide 15 percent of the power necessary to run the Convention Center. George Rakis, general manager of the Los Angeles Convention Center, said *"These solar panels will reap significant energy savings over the years, but will also distinguish Los Angeles and the Los Angeles Convention Center as a leader in this effort."*

Electric Transportation

DWP's electric transportation program made important strides this year, positioning Los Angeles to be well on its way to meeting the State of California's requirement that 10 percent of all new vehicles offered for sale must produce zero emissions by the year 2003. DWP has achieved this position through the development of several important programs.

Developing the Electric Vehicle Infrastructure – DWP's **electric vehicle (EV) infrastructure program** is the most aggressive of its kind in the country. By coordinating the installation of a network of charging stations at a wide range of public sites and city facilities and partnering with business, industrial customers, and government agencies, DWP has established or upgraded nearly 400 public, work site, and fleet charging stations at locations including event centers, shopping malls, university campuses, and others.

Electric Vehicle Use – DWP currently utilizes more than 80 EVs for carpools, meter reading, and other field applications. Because Los Angeles is one of the prime EV markets in the nation, DWP plans to support the growth of clean-fuel transportation use by continuing to acquire EVs and by assisting

consumer and fleet drivers in doing the same.

Electric Transportation Demonstration Projects – As part of its **leadership role in the electric transportation arena**, DWP helps other agencies integrate EVs and electric public transit into their fleets.

For example, DWP has:

- Partnered with the post office in Harbor City to convert its entire fleet to EVs – a first in the nation.
- Partnered with the U.S. Postal Service to provide charging infrastructure to support more than 100 electric delivery vehicles in Los Angeles.
- Continued to work with the Los Angeles Department of Transportation and Port of Los Angeles to oversee the electric powered San Pedro Trolleys.
- Coordinated with Budget EV Rental Cars in a joint effort to deploy a demonstration electric bus at the firm's Los Angeles International Airport (LAX) facility.
- Provided access to EV fast charging in downtown Los Angeles, as well as assistance with the installation of fast charging equipment near LAX, to aid Xpress Shuttle's operation of electric shuttle vans between downtown and LAX.

Electric Transportation Services for Businesses –

DWP has developed a **model facility** in downtown Los Angeles for servicing EVs and training technicians and others in the handling of these vehicles. To help businesses incorporate EVs into their fleets and place charging stations at their sites, DWP provides information on EV availability, incentives and fuel savings, and also hosts tours of its EV Service Center.



Above left: DWP provided electric shuttles for the Democratic National Convention, and partners with other businesses to help support the use of electric public transportation for the sake of cleaner air. Above right: The Department of Water and Power continues to provide reliable, inexpensive water and electricity to the thriving city of Los Angeles and its 3.8 million residents.

Electric Transportation Services for Residential Customers – To encourage the use of EVs and promote charging of vehicles at home, at night – when power demands are lowest – DWP has continued to offer a discount charging rate to customers charging their vehicles at home that translates to, on average, just one-third the cost of gasoline.

Energy Efficiency

Over the course of the past year, DWP has introduced a number of efficiency solutions for its customers. These programs, which fall under the banner of "Efficiency 2000," offer incentives, advice and technical assistance to DWP customers for making energy-efficiency improvements designed to reduce customer electricity costs.

HVAC Incentives – This new energy efficiency program for heating, ventilating and air conditioning systems (HVAC) offers residential and commercial customers two options: 1) a tune-up of their HVAC systems to increase operating efficiency, resulting in lower energy bills; and 2) replacement, at discounted prices, of air conditioners, heat pumps and products designed to reduce cooling loads.

CLEO Lighting Program – The Commercial Lighting Efficiency Offer (CLEO) program assists DWP commercial customers by offering cash incentives for installation of qualifying products, reduced electricity costs for improved workplace lighting, lower lighting maintenance costs, and cash incentives of up to \$400 for every peak-period kilowatt reduced with lighting system retrofits.

Chiller Efficiency Program – This program offers exceptional cash incentives of up to \$400 per kilowatt reduced to owners and operators of buildings and manufacturing plants that use either water-cooled or air-cooled chillers. And, in addition to this DWP incentive, the use of a new, high-efficiency chiller can result in electricity savings totaling hundreds of thousands of dollars over the chiller's operating lifetime.

Refrigeration Services – DWP is offering **no-cost and low-cost solutions** for small- and medium-size businesses to reduce refrigeration costs. Partnering with refrigeration specialists, DWP will perform a free "working audit" of the refrigeration unit, a tune up, and a frank assessment of the equipment. DWP will pay for the cleaning of the refrigeration unit one time per customer during the first year of the program, and tips on how to maintain the refrigeration equipment will be provided with recommendations on energy savings and equipment upgrades.

Energy Advisor – DWP maintains and offers a web page www.GreenLA.com as a source of reliable information and advice on energy-related technologies and management. These guides offer customers the information they need to know when acquiring energy-using products in commercial buildings. Some of the major topic areas featured at this site are: lighting, HVAC, water heating, refrigeration, office equipment, motors, building shell, as well as a section for customer feedback.

Efficient Refrigerator Program – DWP is offering high-efficiency refrigerators for sale at high volume discounted prices. These are units that are not currently available in the California retail market and give customers the opportunity to reduce their electricity costs and help the improvement of the environment for generations to come.

Owens Valley Restoration and Land Management

The DWP continues its protective stewardship of the Owens Valley, the wellspring of more than 50 percent of Los Angeles' water supply. **Many important milestones** were reached over the past year

in restoring and maintaining one of the country's largest watersheds. While negotiations continue over technical details of project implementation, the main philosophical differences among the City of Los Angeles, Owens Valley residents and state and federal agencies have been resolved.

The approaches and concepts DWP developed in the Owens Valley watershed are a **model for other watersheds** and, in fact, set the standards against which other projects around the world can be measured. Research performed by the Department in support of its management has advanced ecosystem restoration science.

The bottom line – marked improvements are being made and more are on the horizon. These improvements include large and small projects, all of which make a big impact in **preserving the natural beauty** of this area and quality of life for its residents.

One positive program is the Owens Dry Lake Dust Mitigation Program. Owens dry lakebed is a significant source of air pollution, as strong winds over Owens Lake blow high levels of dust, and other particulate matter, into the air.

In July 2000, the City of Los Angeles awarded a \$60 million contract to design, build and operate the shallow-flooding irrigation program to **provide dust relief** to the Owens Lake region. The contract was awarded to Barnard Construction Company, a construction-engineering firm with a solid reputation and expertise with large-scale environmental projects.

In addition to the shallow flooding project, vegetation and gravel will be utilized to help combat dust. Visitors to the Owens Lake can see native saltgrass being grown on the harsh surface of Owens Lake as part of a research project to determine its viability as a dust control measure.

The design portion of the project was scheduled for completion in fall 2000. The construction phase of the project is anticipated to be completed by October 2001. The facility is scheduled to be fully operational, covering more than 13 square miles of the lakebed with water, by December 31, 2001.

To discuss the dramatic changes in place at Owens Lake, DWP General Manager S. David Freeman held a community open house meeting in Lone Pine in September 2000. There, residents from the communities impacted by the dust storms off of Owens Lake were given an overview of the project design – including the 100-foot breach in the Los Angeles Aqueduct recently created to bring water to Owens Lake for the shallow flooding irrigation. In addition, Mr. Freeman introduced the contract management team from Barnard Construction and took questions and comments from the audience. Although these residents have been subjected to dust problems for many years, they genuinely expressed their gratitude to the Department for developing and now implementing a solution.

Labor Management Partnership

DWP recognizes the pivotal role of creative labor/management partnerships in addressing the utility's organizational and operational needs. One such partnership is the Department's new Joint Safety Institute (JSI).

The Joint Safety Institute

The Department and the International Brotherhood of Electrical Workers Local 18 embarked on a creative initiative with the establishment of an independent advisory body known as the JSI that addresses the safety of employees, especially the frontline workers, who are exposed to safety hazards on a daily basis. Over the past 10 years, the average serious injury rate of the Department has been approximately twice the national average in the industry. At the same time, annual cost of workers compensation, currently at \$10.5 million, has risen by an average of six percent annually. With the establishment of the JSI, costs associated with workers compensation and long-term injuries are being reduced through worker safety programs, training, safety audits, information sharing and mentoring. **This strategic partnership** between labor and management creates and fosters a culture and environment that effectively promotes workplace health and safety and proactively prevents injuries and illnesses on the job – both of which guarantee timely and accurate service deliveries. It complements the Department's corporate safety group and it increases open communication between labor and management on issues of health and safety. The JSI demonstrates the Department's commitment to a safe and productive workplace and illustrates the continuing efforts of management to make labor a strategic partner in a competitive industry. The JSI serves as an exemplary program for the City. In fact, the City of Los Angeles has started the process to replicate the JSI for the City's Council-controlled departments.

On October 9, 1936, Los Angeles residents celebrated the delivery of the first electricity generated by Colorado River water flowing through the new Hoover Power Plant with a parade and the lighting of searchlights along downtown streets. The event also commemorated the completion of the DWP's Boulder Transmission System, which was the highest-voltage, longest-distance electrical system built at that time.



No public utility takes its community service role more seriously than DWP. Following are some examples of how the Department gives back to its most valuable stakeholders – the citizens of Los Angeles.

Revenue Transfer

DWP continues to meet its commitment to transfer at least 5 percent of gross revenues to the City of Los Angeles General Fund. This year's revenue transfer amounted to \$134 million, an eight percent increase over the previous year, continuing DWP's role as the city's largest "taxpayer." The city uses the DWP funds to help pay for vital municipal services, including police and fire protection, and recreational facilities.

Sponsorships – We're L.A.'s Home Team Too!

"Power Hitter," "Football Frenzy" & "Spot Shot"

More than 3,000 kids from throughout Los Angeles participated in DWP-sponsored community events that paired girls and boys with professional athletes who provided one-on-one instruction in the fundamentals of baseball, football and basketball. Participants vied for the once-in-a-lifetime chance to practice their sport before cheering crowds at Dodger Stadium, Pauley Pavilion, and the Rose Bowl.

DWP's "Dodger Blue on Wheels"

The Los Angeles Dodgers and DWP partnered to create the "Dodger Blue on Wheels," a mobile exhibit of team memorabilia, and educational and interactive games. This innovative community program spent much of the year on the road traveling to inner city communities and reaching more than 5,000 children – courtesy of DWP.

Lighting of the Cascades

On Interstate 5 in Sylmar is the familiar site of DWP's 900-foot long Cascades, the entry point for much of Los Angeles' water supply which arrives here from Owens Valley. In December, the Cascades took on a new look which drew the attention of motorists and news helicopters alike. For the first time in 25 years, the Department lighted the Cascades in four colors – earning this familiar site new notoriety. DWP created a state-of-the-art lighting system which uses highly efficient metal halide lamps that emitted concentrated light through a color wheel and into a fiber optic conductor.



(Above left) Young, aspiring athletes in the city each year have the opportunity to play with the Dodgers and other professional athletes at sport camps sponsored by DWP. (Above right) Employing fiber optics technology, DWP has created a dramatic display of lights along its 900-foot-long Cascades – the entry point where water comes into the L.A. Reservoir Complex from the Owens Valley.

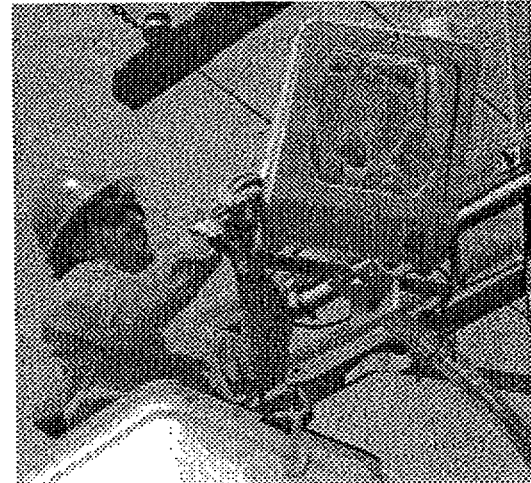
Being a single mom and a high school student with no job skills could have led to a hopeless situation for Raquel Stevenson had it not been for her personal determination and the birth of the Youth Services Academy (YSA). In 1990, when Stevenson's outlook was bleak, her school principal informed her about the YSA program. The program is a joint partnership between DWP and the Los Angeles Unified School District that enables at-risk teens to become productive members of the Los Angeles workforce by learning workplace and basic life skills. She applied to the program and was one of the first students to participate in the job-training academy. "YSA was great for me," she says. "It helped me out when I needed it." Stevenson worked and learned clerical skills in DWP's Security Unit. After passing the clerk typist exam, she was hired immediately in the same unit, where she worked for a year. She credits her mentor, Michelle Moore, with providing help, advice and guidance. After working in Power Services, transferring to the Housing Department and taking an extended maternity leave, Stevenson is now back at DWP as a full-time clerk typist in the L.A. Reservoir Maintenance group. She encourages other students to take advantage of the YSA program. "I want to tell these students to learn as much as possible and be willing to take on new challenges, then they will be able to prosper in life," she says.

Youth Services Academy

This year DWP celebrated its **10-year anniversary of a partnership** with the Los Angeles Unified School District in sponsoring the Youth Services Academy. The Academy is an on-the-job education program designed to aid at-risk youth in learning job skills. This program has trained more than 2,500 students since its inception in 1990.

Outdoor Lighting Program

In a move to make city parks safer at night, DWP installed outdoor lighting at 84 city parks. The energy-efficient lights serve as a **deterrent to crime** and aid police patrols. The program, which enjoys the endorsement of the Los Angeles Police Department, is part of a larger program, available to residential and business customers, under which customers can opt to light areas within 25 feet of their property for a low monthly fee.



DWP lights up the city, providing safety and security, with its outdoor lighting program offered to business and residential customers.

Education Programs

Science Bowl – One of the ways that DWP demonstrated its longstanding commitment to Los Angeles youth this year was its continued sponsorship of the DWP Science Bowl. The purpose of the program is to **recognize outstanding student achievement** in math and science at the high school level and also to increase the interest in the study of technical subjects, especially among female and underrepresented minority students. In this program, local high schools assemble teams of science students who compete against neighboring high schools for the opportunity to compete on a national level. This year, for the third consecutive year, the North Hollywood team won the regional competition and later placed fourth at the national contest held in Washington, D.C.

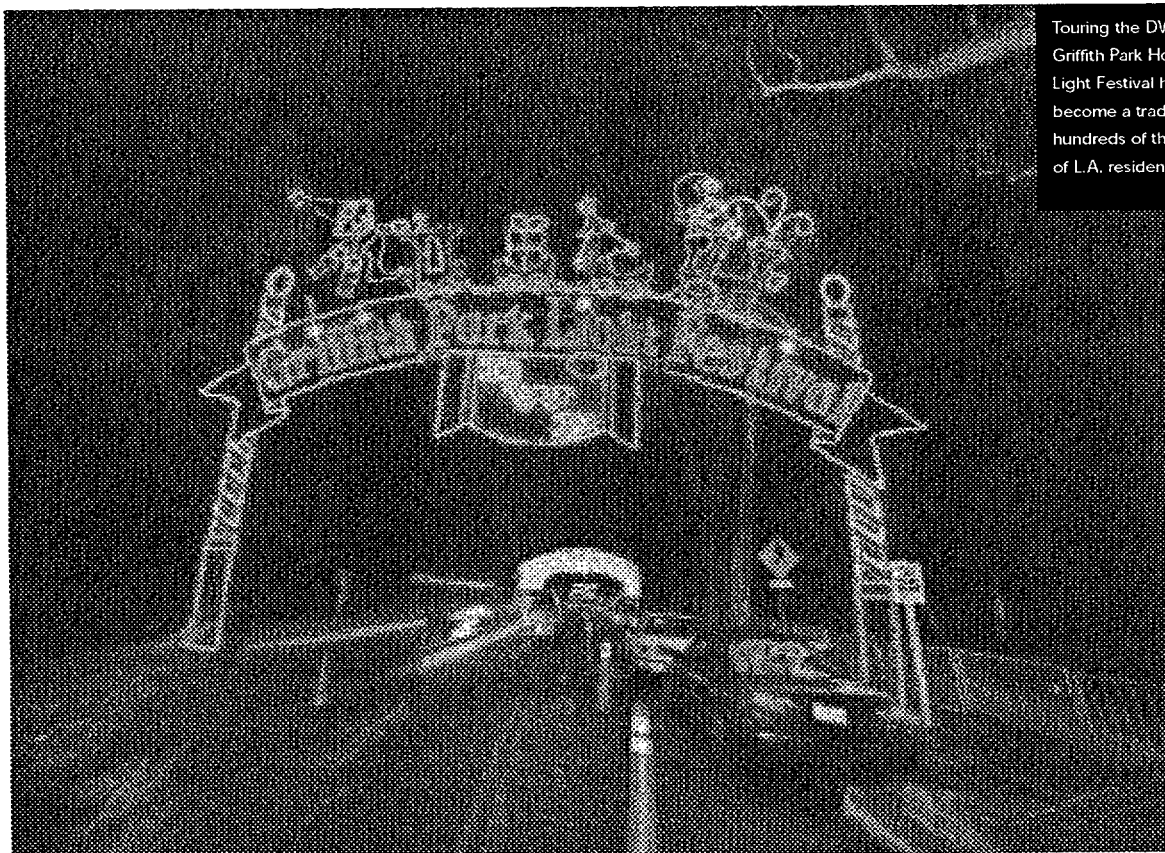
Adopt-a-School – Another manner in which the Department displayed its commitment to local children and their education this year was by

again participating in the Adopt-a-School program. This program brings DWP employees, who volunteer their time, to Los Angeles area schools to work with students in the classroom. This year, DWP adopted 10 elementary schools and one high school.

Energy 2000 Calendar Contest – DWP sponsored the California Energy Commission's "Energy 2000 Calendar Contest." The statewide contest asked young artists to portray a future in which creative, cutting-edge technologies power a clean and secure society, as part of a calendar. Aaron Yamagata, Christopher Abkarians and Alfredo Campos were three Los Angeles students whose artwork was selected for the calendar.

Griffith Park Holiday Lighting

During the 1999 holiday season, the Department continued its commitment to the community by sponsoring the Fourth Annual DWP and Griffith Park Holiday Light Festival along Crystal Springs Drive in the park. More than 24 colorful animated displays were lighted by 620,000 watts of light bulbs. The festival ran from November 26 through December 26.



Touring the DWP and Griffith Park Holiday Light Festival has become a tradition for hundreds of thousands of L.A. residents.

Water Services

Report and Financial Statements:

Report of Independent Accountants

Balance Sheets

Statements of Income

Statements of Cash Flows

Notes to Financial Statements

❖ ❖ ❖

Energy Services

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Notes to Financial Statements

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

In our opinion, the accompanying balance sheets 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 the Water System (Water Services) of the Department of Water and Power of the City of Los Angeles at June 30, 2000 and 1999, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2000 in conformity with accounting principles generally accepted in the United States of America. 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 auditing standards generally accepted in the United States of America, 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 our opinion.

Richard H. Coopers C.P.A.

Los Angeles, California
September 15, 2000

Water Services Balance Sheets

| (Amounts in thousands) | 2000 | June 30, 1999 |
|--|---------------------|---------------------|
| ASSETS | | |
| Utility Plant | | |
| Source of water supply | \$ 363,004 | \$ 304,394 |
| Pumping | 169,565 | 165,592 |
| Purification | 221,270 | 209,583 |
| Distribution | 2,211,820 | 2,102,406 |
| General | 308,066 | 301,926 |
| | <u>3,273,725</u> | <u>3,083,901</u> |
| Accumulated depreciation | 1,155,735 | 1,078,740 |
| | <u>2,117,990</u> | <u>2,005,161</u> |
| Construction work in progress | 196,710 | 172,381 |
| | <u>2,314,700</u> | <u>2,177,542</u> |
| Restricted Investments | <u>308,186</u> | <u>307,706</u> |
| Current Assets | | |
| Cash and cash equivalents | 106,876 | 62,566 |
| Cash collateral received from securities lending transactions | 25,216 | 20,219 |
| Customer and other accounts receivable, net of \$3,500 and \$4,500 allowance for losses | 68,508 | 79,608 |
| Due from Energy Services | 1,344 | 2,208 |
| Accrued unbilled revenue | 42,447 | 37,252 |
| Materials and supplies, at average cost | 15,753 | 15,284 |
| Prepayments and other current assets | 12,273 | 3,287 |
| | <u>272,417</u> | <u>220,424</u> |
| Net Pension Asset | 45,513 | 47,845 |
| | <u>\$ 2,940,816</u> | <u>\$ 2,753,517</u> |
| CAPITALIZATION AND LIABILITIES | | |
| Equity | | |
| Retained income reinvested in the business | \$ 1,065,845 | \$ 968,091 |
| Contributions in aid of construction | 589,315 | 576,597 |
| | <u>1,655,160</u> | <u>1,544,688</u> |
| Long-term Debt | 709,498 | 629,012 |
| Advance Refunding Bonds | 315,968 | 315,841 |
| | <u>2,680,626</u> | <u>2,489,541</u> |
| Current Liabilities | | |
| Debt due within one year | 19,700 | 18,720 |
| Accounts payable and accrued expenses | 72,250 | 59,960 |
| Accrued interest | 14,726 | 13,714 |
| Accrued employee expenses | 20,162 | 17,189 |
| Obligations under securities lending transactions | 25,216 | 20,219 |
| Overrecovered costs | 183 | 36,940 |
| Customer deposits | 38,766 | 40,174 |
| | <u>191,003</u> | <u>206,916</u> |
| Accrued Postretirement Liability | 69,187 | 57,060 |
| Commitments and Contingencies (Note 8) | — | — |
| | <u>\$ 2,940,816</u> | <u>\$ 2,753,517</u> |

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

| (Amounts in thousands) | 2000 | Year Ended June 30, 1999 | 1998 |
|--|-------------------|-----------------------------|------------------|
| Operating Revenues | | | |
| Residential | \$ 207,873 | \$ 173,812 | \$ 159,407 |
| Multiple dwelling units | 153,356 | 139,217 | 135,037 |
| Commercial and industrial | 118,311 | 104,927 | 105,131 |
| Other | 30,663 | 25,456 | 25,475 |
| | <u>510,203</u> | <u>443,412</u> | <u>425,050</u> |
| Operating Expenses | | | |
| Purchased water | 91,275 | 37,192 | 40,719 |
| Other operating expenses | 135,982 | 143,887 | 148,771 |
| Maintenance | 55,730 | 59,000 | 65,098 |
| Depreciation | 70,590 | 68,299 | 65,362 |
| | <u>353,577</u> | <u>308,378</u> | <u>319,950</u> |
| Operating Income | <u>156,626</u> | <u>135,034</u> | <u>105,100</u> |
| Other Income and Expense | | | |
| Investment income (loss) | 9,475 | (3,907) | 8,685 |
| Gain on sale of land | — | 5,524 | — |
| Other, net | 565 | (153) | 1,909 |
| | <u>10,040</u> | <u>1,464</u> | <u>10,594</u> |
| Debt Expenses | | | |
| Interest on debt | 47,958 | 44,987 | 45,738 |
| Allowance for funds used during construction | (1,246) | (2,610) | (1,910) |
| | <u>46,712</u> | <u>42,377</u> | <u>43,828</u> |
| Net Income | <u>\$ 119,954</u> | <u>\$ 94,121</u> | <u>\$ 71,866</u> |

Statements of Retained Income Reinvested in the Business

| (Amounts in thousands) | 2000 | Year Ended June 30, 1999 | 1998 |
|--|--------------------|-----------------------------|-------------------|
| Balance at beginning of year | \$ 968,091 | \$ 890,222 | \$ 844,270 |
| Net income for the year | 119,954 | 94,121 | 71,866 |
| Less – Transfers to the reserve fund of the City of Los Angeles | <u>22,200</u> | <u>16,252</u> | <u>25,914</u> |
| Balance at end of year | <u>\$1,065,845</u> | <u>\$ 968,091</u> | <u>\$ 890,222</u> |

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

Water Services Statements of Cash Flows

| (Amounts in thousands) | Year Ended June 30, | | |
|---|---------------------|------------------|------------------|
| | 2000 | 1999 | 1998 |
| Cash Flows from Operating Activities: | | | |
| Operating income | \$ 156,626 | \$ 135,034 | \$ 105,100 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | | |
| Depreciation | 70,590 | 68,299 | 65,362 |
| Provision for losses on customer and other accounts receivable | 2,478 | 2,172 | 3,595 |
| Changes in assets and liabilities: | | | |
| Customer and other accounts receivable | 7,976 | (18,967) | (6,057) |
| Net pension asset | 2,332 | (12,079) | (29,030) |
| Accounts payable and accrued expenses | 12,290 | (4,315) | 18,211 |
| Overrecovered costs | (36,757) | (6,548) | 8,639 |
| Accrued postretirement liability | 12,127 | 11,324 | 20,989 |
| Other assets and liabilities | (11,656) | 6,773 | 4,803 |
| | <u>216,006</u> | <u>181,693</u> | <u>191,612</u> |
| Cash Flows from Noncapital Financing Activities: | | | |
| Payments to the reserve fund of the City of Los Angeles | <u>(22,200)</u> | <u>(21,252)</u> | <u>(20,914)</u> |
| Cash Flows from Capital and Related Financing Activities: | | | |
| Additions to plant and equipment, net | (206,502) | (155,580) | (151,131) |
| Contributions in aid of construction | 12,718 | 26,383 | 17,205 |
| Gain on sale of land | — | 5,524 | — |
| Proceeds from escrow investment maturities | 13,555 | 65,968 | 14,742 |
| Purchases of escrow investments | (9,613) | (235,069) | — |
| Sale of revenue bonds and refunding bonds, net | 99,132 | 233,395 | — |
| Principal payments and maturities of long-term debt | (18,720) | (77,881) | (30,857) |
| Debt interest payments | (59,333) | (56,365) | (53,660) |
| | <u>(168,763)</u> | <u>(193,625)</u> | <u>(203,701)</u> |
| Cash Flows from Investing Activities: | | | |
| Investment income | <u>19,267</u> | <u>12,565</u> | <u>13,822</u> |
| Cash and Cash Equivalents: | | | |
| Net increase (decrease) | 44,310 | (20,619) | (19,181) |
| Beginning of year | <u>62,566</u> | <u>83,185</u> | <u>102,366</u> |
| | <u>\$ 106,876</u> | <u>\$ 62,566</u> | <u>\$ 83,185</u> |

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

NOTE 1: Summary of Significant Accounting Policies

The Department of Water and Power of the City of Los Angeles (the Department) exists as a separate proprietary agency of the City of Los Angeles (the City) under and by virtue of the City Charter enacted in 1925. The Department's Water System (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 accounting principles generally accepted in the United States of America. As a government-owned utility, the Department applies all statements issued by the Governmental Accounting Standards Board (GASB) and all statements and interpretations issued by the Financial Accounting Standards Board which are not in conflict with statements issued by the GASB. In addition, the Department's 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 in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, which requires 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, 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 No. 71, but will continue to evaluate its applicability based on changes in the regulatory and competitive environment.

Use of estimates – 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.

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 (AFUDC), 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 maintenance, repairs and minor replacements are charged to the appropriate operations and maintenance expense accounts. The original cost of property retired, net of removal and salvage costs, is charged to accumulated depreciation.

Depreciation – Depreciation expense is computed using the straight-line method based on service lives. Estimated service lives range from 5 to 70 years. Depreciation expense as a percentage of average depreciable utility plant in service was 2.6% for each of the fiscal years 2000, 1999 and 1998.

Cash and cash equivalents – The Department's cash is deposited with the City Treasurer in the City's general investment pool. The City Treasurer invests available funds of the City and its independent operating departments on a combined basis. At June 30, 2000 and 1999, cash and cash equivalents includes \$12 million of internally-designated balances relating to bond redemption and interest funds and a self-insurance fund. In addition, at June 30, 2000, the cash and cash equivalents balance includes \$70 million of funds restricted by bond indenture for use in construction. The Department considers all unrestricted investments with an original maturity of three months or less to be cash equivalents.

Investments – Investments include United States Government and governmental agency securities. Investments are reported at fair value and changes in unrealized gains and losses are recorded in the Statement of Income. Gains and losses realized on the sale of investments are generally determined using the specific identification method.

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 is shown in the accompanying balance sheet as a component of equity.

Revenues – Water Services' rates are established by a rate ordinance which is approved by the City Council. Water Services sells water to other City departments at rates provided in the ordinance. Water Services recognizes water costs in the period incurred and accrues for estimated water sold but not yet billed.

Revenues consist of billings to customers for water consumption at rates specified by the water rate ordinance. These rates include a cost adjustment factor that provides Water Services with full recovery of purchased water costs. Water Services is also authorized to collect approved demand-side management, water reclamation and water quality improvement expenditures. Management estimates these costs to establish the cost recovery component of customer billings and any difference between billed and actual costs is adjusted in subsequent billings. This difference is reflected as overrecovered costs on the balance sheet.

The rate ordinance limits Water Services' recovery of combined expenditures for demand-side management, water reclamation and water quality improvement. During fiscal year 2000, Water Services funded \$17 million of water quality improvement expenditures through funds received from the issuance of debt. Although expenditures were in excess of current period recoveries, the rate ordinance permits future recovery of principal and interest payments related to debt used to fund approved expenditures.

Debt expenses – Debt premium, discount and issue expenses are deferred and amortized to expense over the lives of the related debt issues. Losses on refundings related to bonds redeemed by proceeds from the issuance of new bonds are amortized over the shorter of the life of the new bonds or the remaining term of the bonds refunded.

Allowance for funds used during construction – Allowance for funds used during construction represents the cost of borrowed funds used for the construction of utility plant. Capitalized AFUDC is included as part of the cost of utility plant and as a reduction of debt expenses. The average AFUDC rate was 6.3%, 6.4% and 6.4% for fiscal years 2000, 1999 and 1998, respectively.

Reclassification – Certain financial statement items for prior years have been reclassified to conform to the current year presentation.

NOTE 2: Securities Lending Transactions

In December 1999, the Department initiated a securities lending program managed by its custodial bank. The bank lends up to 20% of the Department's eligible assets for securities, cash collateral or letters of credit equal to 102% of the market value of the loaned securities and interest, if any. The Department can sell collateral securities only in the event of borrower default. The lending agent provides indemnification for borrower default. There were no violations of legal or contractual provisions and no borrower or lending agent default losses during the year.

As of June 30, 2000, Water Services had securities lending obligations related to corporate fixed income securities with a fair value of \$5 million. These securities were lent for cash collateral of \$5 million.

General Investment Pool Program – The Department also participates in the City's securities lending program through the pooled investment fund. The City's program has substantially the same terms as the Department's direct securities lending program. The Department recognizes its proportionate share of the cash collateral received for securities loaned and the related obligation for the general investment pool. Water Services' attributed share of cash collateral and the related obligation from the City's program consisted of \$20 million as of June 30, 2000 and 1999.

Management believes that participation in these securities lending programs results in no credit risk exposure to the Department because the amounts owed to the borrowers exceed the amounts borrowed.

NOTE 3: Long-term Debt and Advance Refunding Bonds

Long-term debt outstanding consists of revenue bonds and refunding revenue bonds due serially in varying annual amounts as follows (amounts in thousands):

| Bond Issues | Date of Issue | Effective Interest Rate | Fiscal Year of Last Scheduled Maturity | Principal Outstanding |
|--|---------------|-------------------------|--|-----------------------|
| Issue of 1971 | 02/01/71 | 5.479% | 2011 | 6,600 |
| Issue of 1972 | 02/01/72 | 5.127% | 2012 | 6,000 |
| Second Issue of 1972 | 08/15/72 | 5.180% | 2013 | 6,500 |
| Issue of 1973 | 09/15/73 | 5.249% | 2014 | 7,000 |
| Refunding Issue of 1977 | 02/01/77 | 5.804% | 2015 | 19,650 |
| Refunding Issue of 1989 | 11/01/89 | 7.060% | 2022 | 16,195 |
| Issue of 1991 | 04/01/91 | 7.053% | 2031 | 71,100 |
| Second Issue of 1991 | 11/01/91 | 6.623% | 2032 | 96,600 |
| Refunding Issue of 1992 | 02/01/92 | 6.435% | 2028 | 63,110 |
| Issue of 1992 | 04/15/92 | 6.559% | 2032 | 48,300 |
| Second Issue of 1992 | 07/15/92 | 6.114% | 2033 | 68,900 |
| Refunding Issue of 1993 | 04/15/93 | 5.880% | 2024 | 80,230 |
| Second Refunding Issue of 1993 | 12/01/93 | 5.297% | 2030 | 135,240 |
| Issue of 1994 | 07/01/94 | 6.338% | 2035 | 50,000 |
| Issue of 1995 | 05/15/95 | 6.111% | 2025 | 48,750 |
| Refunding Issue of 1998 | 10/15/98 | 4.689% | 2035 | 235,730 |
| Issue of 1999 | 10/15/99 | 6.139% | 2040 | 100,000 |
| Total principal amount | | | | \$ 1,059,905 |
| Unamortized debt-related costs (including net loss on refundings) | | | | (14,739) |
| Long-term debt due within one year | | | | (19,700) |
| | | | | <u>\$ 1,025,466</u> |

The revenue bonds generally are callable ten years after issuance. The Department has agreed to certain covenants with respect to its bonded indebtedness. Significant covenants include 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. The revenue bonds and refunding revenue bonds are secured by the future revenues of Water Services.

Advance refunding bonds – In prior years, Water Services established irrevocable escrow trusts with the proceeds from issuance of refunding bonds. Escrow investments of \$308 million (stated at fair value as of June 30, 2000) will be used to refund bonds presently included in long-term debt at scheduled redemption dates as follows (amounts in thousands):

| Bond Issues | Redemption Date | Principal Amount to be Redeemed |
|----------------------|-----------------|---------------------------------|
| Issue of 1991 | 04/01/01 | \$ 69,600 |
| Second Issue of 1991 | 11/01/01 | 81,400 |
| Issue of 1992 | 04/15/02 | 40,700 |
| Second Issue of 1992 | 07/15/02 | 53,100 |
| Issue of 1994 | 07/01/04 | 38,400 |
| Issue of 1995 | 05/15/05 | 29,120 |
| | | <u>\$ 312,320</u> |

The related advance refunding bonds will be reclassified to long-term debt from advance refunding bonds at the time that the bonds to be refunded are called. Interest expense from refunding bonds and interest income earned on related escrow investments are included in investment income.

Scheduled principal maturities – Scheduled annual principal maturities during the five fiscal years following June 30, 2000 are \$20, \$21, \$22, \$23 and \$24 million, respectively. These scheduled maturities exclude the impact of mandatory redemptions with escrow investments.

Fair value – The fair value of long-term debt and advance refunding bonds is \$1.02 billion and \$994 million at June 30, 2000 and 1999, respectively. Management has estimated fair value based on 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.

NOTE 4: Retirement, Disability and Death Benefit Insurance Plan

The Department has a funded contributory retirement, disability and death benefit insurance plan covering substantially all of its employees. The Water and Power Employees' Retirement, Disability and Death Benefit Insurance Plan (the Plan) operates as a single-employer benefit plan to provide pension benefits to eligible Department employees and to provide disability and death benefits from the respective insurance funds. Plan benefits are generally based on years of service, age at retirement and the employee's highest 12 consecutive months of salary before retirement. Active participants who joined the plan on or after June 1, 1984 are required to contribute 6% of their annual covered payroll. Participants who joined the plan prior to June 1, 1984 contribute an amount based upon an entry-age percentage rate. The Department contributes \$1.10 for each \$1.00 contributed by participants plus an actuarially determined annual required contribution as determined by the Plan's independent actuary. The contributions are allocated between Water Services and Energy Services based on the current year labor costs.

The Retirement Board of Administration (the Retirement Board) is the administrator of the Plan. The Plan 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 Board of Commissioners). The Plan is an independent pension trust fund of the Department.

Plan amendments must be approved by both the Retirement Board and the Board of Commissioners. During March 1998, two amendments were made to the Plan. The amendments change the retirement age required to receive unreduced benefits with thirty years of service from 55 to 50 years of age, and provide participants with the option of purchasing other governmental service for purposes of enhancing benefits and eligibility for retirement. These amendments are considered in the actuarial determination of annual required contributions.

Water Services' allocated share of annual pension cost (APC) and net pension obligation (NPO) consists of the following (amounts in millions):

| | Year Ended June 30, | |
|--|---------------------|----------------|
| | 2000 | 1999 |
| Annual required contribution | | |
| Interest on net pension asset | \$ - | \$ - |
| Adjustment to annual required contribution | (3) | (2) |
| | <u>11</u> | <u>7</u> |
| APC (including \$3 and \$2 million of amounts capitalized in fiscal 2000 and 1999, respectively) | 8 | 5 |
| Department contributions | (8) | (18) |
| Shared operating expenses (see Note 7) | <u>2</u> | <u>1</u> |
| Change in NPO | 2 | (12) |
| NPO (asset) at beginning of year | <u>(48)</u> | <u>(36)</u> |
| NPO (asset) at end of year | <u>\$ (46)</u> | <u>\$ (48)</u> |

Annual required contributions are determined through actuarial valuations using the entry age normal actuarial cost method. The actuarial value of assets in excess of the Department's actuarial accrued liability (AAL) is being amortized by level contribution offsets over the period ending June 30, 2003. As a result of an April 2000 amendment to the Plan, the amortization period will be changed to rolling fifteen year periods effective July 1, 2000.

In accordance with actuarial valuations, the Department's required contribution rates are as follows:

| Actuarial Valuation Date June 30 | Normal Cost | Surplus Amortization | Contribution Rate |
|----------------------------------|-------------|----------------------|-------------------|
| 1999 | 10.57% | -26.72% | 0.00% |
| 1998 | 9.64% | -13.39% | 0.00% |
| 1997 | 9.14% | -1.82% | 7.32% |

The significant actuarial assumptions include an investment rate of return of 8%, projected inflation-adjusted salary increases of 5.5%, and postretirement benefit increases of 3%. The actuarial value of assets is determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period. Plan assets consist primarily of corporate and government bonds, common stocks, mortgage-backed securities and short-term investments.

Trend information for the current and two preceding fiscal years for Water Services is as follows (amounts in millions):

| Year Ended June 30 | NPO | Percentage of APC Contributed | APC |
|--------------------|---------|-------------------------------|------|
| 2000 | \$ (46) | 71% | \$ 8 |
| 1999 | \$ (48) | 285% | \$ 5 |
| 1998 | \$ (36) | 350% | \$ 9 |

The following schedule provides information about the Department's overall progress made in accumulating sufficient assets to pay benefits when due, prior to allocations to Water Services and Energy Services (amounts in millions):

| Actuarial Valuation Date June 30, | Actuarial Value of Assets | AAL | Actuarial Assets Over AAL | Funded Ratio | Covered Payroll | Overfunding as a % of Covered Payroll |
|-----------------------------------|---------------------------|----------|---------------------------|--------------|-----------------|---------------------------------------|
| 1999 | \$ 5,254 | \$ 4,911 | \$ 343 | 107% | \$ 355 | 97% |
| 1998 | \$ 4,514 | \$ 4,340 | \$ 174 | 104% | \$ 431 | 40% |
| 1997 | \$ 3,851 | \$ 3,812 | \$ 39 | 101% | \$ 430 | 9% |

The Department's measurement, recognition and disclosure of pension information is in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*.

Disability and death benefits – Water Services' allocated share of disability and death benefit plan costs and administrative expenses totaled \$4 million for each of the fiscal years 2000, 1999, and 1998.

NOTE 5: Health Care Costs

The Department provides certain health care benefits to active and retired employees and their dependents. The total number of active and retired Department participants entitled to receive benefits was approximately 15,000 at June 30, 2000. The allocated cost to Water Services of providing such benefits amounted to \$25, \$22, and \$37 million for fiscal years 2000, 1999 and 1998, respectively. Of these costs, \$9, \$7, and \$12 million were capitalized and the remainder was charged to expense for fiscal years 2000, 1999 and 1998, respectively.

Postretirement benefits – The Department accounts for postretirement benefits in accordance with SFAS 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' allocated share of postretirement benefit costs is summarized as follows (amounts in millions):

| | 2000 | Year Ended June 30, 1999 | 1998 |
|---------------------------------------|--------------|-----------------------------|--------------|
| Service cost | \$ 2 | \$ 2 | \$ 3 |
| Interest cost | 9 | 7 | 7 |
| Expected return on plan assets | (1) | (1) | (1) |
| Amortization of transition obligation | 4 | 4 | 4 |
| Amortization of prior service costs | 2 | – | – |
| Curtailment loss | – | – | 9 |
| Special termination benefits | – | 2 | 4 |
| | <u>\$ 16</u> | <u>\$ 14</u> | <u>\$ 26</u> |

The funded status and the accrued benefit cost related to postretirement benefits for the Department, prior to allocations to Water Services and Energy Services, are summarized as follows (amounts in millions):

| | 2000 | June 30, 1999 |
|---|-----------------|------------------|
| Change in benefit obligation: | | |
| Benefit obligation at beginning of year | \$ 513 | \$ 454 |
| Service cost | 10 | 8 |
| Interest cost | 39 | 30 |
| Actuarial losses | 58 | 37 |
| Plan amendment | 46 | – |
| Special termination benefits | – | 9 |
| Benefits paid | (30) | (25) |
| Benefit obligation at end of year | <u>636</u> | <u>513</u> |
| Change in fair value of plan assets: | | |
| Fair value of plan assets at beginning of year | 69 | 65 |
| Actual return on plan assets | 2 | 4 |
| Fair value of plan assets at end of year | <u>71</u> | <u>69</u> |
| Funded status | (565) | (444) |
| Unrecognized net loss | 63 | 4 |
| Unrecognized transition obligation | 197 | 212 |
| Unrecognized prior service cost | 62 | 23 |
| Accrued benefit cost | <u>\$ (243)</u> | <u>\$ (205)</u> |
| Water Services' allocated share of accrued benefit cost | <u>\$ (69)</u> | <u>\$ (57)</u> |

Weighted average actuarial assumptions used in determining postretirement benefit costs are as follows:

| | 2000 | June 30, 1999 | 1998 |
|--------------------------------|-------|------------------|-------|
| Discount rate | 7.75% | 7.25% | 6.75% |
| Expected return on plan assets | 7.00% | 7.00% | 7.00% |

Plan assets consist primarily of short-term treasury obligations. No funding policy has been established for the future benefit to be provided under this plan.

For measurement purposes, an 8.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2000; the rate was assumed to decrease gradually to 5.75% in 2007 and remain at that level thereafter. The effect of a 1% change in these assumed health care cost trend rates would increase or decrease the Department's total benefit obligation by approximately \$78 million or \$71 million, respectively. In addition, such a 1% change would increase or decrease the aggregate service and interest cost components of net periodic benefit cost by approximately \$8 million.

During fiscal year 2000, the Department began contributing toward dental coverage for retirees enrolled in a Department-sponsored plan. This amendment resulted in a \$46 million increase in the Department's accumulated postretirement benefit obligation at June 30, 2000. Water Services' allocated \$11 million share of this increase is being amortized through 2008, the remaining average service period. This change also resulted in an \$8 million increase in postretirement benefit costs for fiscal year 2000, of which \$2 million was allocated to Water Services.

During fiscal year 1998, the Department implemented two changes in postretirement benefits to employees. The changes increased the subsidy rate applicable to retirees under age 65 with a spouse under age 65 and granted service credit years to employees and retirees with qualified service to other governmental organizations. These permanent changes resulted in a \$25 million increase in the Department's accumulated postretirement benefit obligation. Water Services' allocated \$6 million share of this increase is being amortized through 2010, the remaining average service period.

The Department recognized curtailment and termination charges of \$9 and \$49 million during fiscal years 1999 and 1998, respectively, related to employees who accepted benefits under the Staff Reduction Program (see Note 6). Water Services included its allocated share of these charges of \$2 and \$13 million related to fiscal years 1999 and 1998, respectively, in postretirement benefit costs.

NOTE 6: Staff Reduction Program

During fiscal year 1998, the Board of Commissioners approved the Staff Reduction Program (the SRP). The SRP was a voluntary program which offered monetary compensation or enhanced retirement benefits to employees during an acceptance period from June 1, 1998 to July 15, 1998.

The number of employee acceptances during the enrollment period was as follows:

| | Year Ended June 30, | |
|---------------------|---------------------|--------------|
| | 1999 | 1998 |
| Monetary benefits | 284 | 438 |
| Enhanced retirement | 502 | 839 |
| | <u>786</u> | <u>1,277</u> |

The cost of monetary benefits offered under the SRP was recognized in the fiscal year employees elected to accept the package. The Department's total cost of monetary benefits offered under the SRP was \$32 million, which included \$12 million and \$20 million related to employee acceptances in fiscal years 1999 and 1998, respectively. Water Services included its \$5 million share of these costs for each of the fiscal years 1999 and 1998 in other operating expenses. The cost of enhanced retirement benefits related to the SRP is considered in the determination of future actuarially required contributions to the retirement plan.

NOTE 7: 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 benefits provided. Operating expenses shared with Energy Services were \$466, \$430, and \$440 million for fiscal years 2000, 1999 and 1998, respectively, of which \$150, \$146, and \$143 million were allocated to Water Services.

NOTE 8: 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. 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 \$22 million in fiscal year 2000 from Water Services to the reserve fund of the City. The Department expects to make a transfer declaration from Water Services of approximately \$25 million during fiscal year 2001.

Environmental matters

Surface Water Treatment Rule – The Department is subject to the State of California Surface Water Treatment Rule (SWTR) which increases filtration requirements at open distribution reservoirs. The Department has four major reservoirs subject to the SWTR: Upper and Lower Hollywood, Lower Stone Canyon and Encino. Under the terms of an agreement with the State Department of Health Services, all four reservoirs are scheduled to be in compliance with the filtration requirements by the end of 2004. The Department plans to comply with the SWTR by removing these reservoirs from regular service through construction of larger pipelines and storage facilities. These changes will allow water from other Department facilities to be supplied to the reservoir service areas.

As of June 30, 2000, the Department has incurred capital costs of approximately \$181 million associated with SWTR compliance. These costs relate to engineering studies and construction activities at the four reservoirs. As of June 30, 2000, management estimates that the total cost of compliance with the SWTR will be approximately \$325 million.

Owens Valley – During July 1997, the Great Basin Unified Air Pollution Control District (the District) adopted an initial State Implementation Plan and an implementing order requiring the Department to initiate pollution control measures to control particulate matters emitting from the Owens Dry Lake bed. The Department disputed the remediation measures imposed by the original order; however, in July 1998, the Board of the District and the City Council approved a Memorandum of Agreement (MOA) resolving the level of control measures required.

Under the MOA, the City committed to providing control measures on the lake bed in a phased manner until the lake bed emissions are reduced to a level that complies with the requirements of the Federal Clean Air Act. In addition, the District agreed to adopt a revised State Implementation Plan (SIP) that extends the period for the City to complete the installation of control measures until 2006, which is the deadline currently required by the Clean Air Act. In November 1998, the District approved the revised SIP, which incorporated the provisions of the MOA. The SIP was subsequently approved by the California Air Resources Board and ultimately by the United States Environmental Protection Agency in August 1999. The SIP anticipates that the City will have control measures in place over a minimum of 22.5 miles of the lake bed by 2006. It is estimated that about 40,000 acre feet of water will be required on an annual basis to operate the pollution control facilities. The current plan assumes that a portion of this water will be obtained from the local sub-potable groundwater basin, however, the actual quantity available will not be known until additional studies are completed.

As of June 30, 2000, the Department has incurred capital costs of approximately \$10 million associated with the Owens Dry Lake. Based on the current plan, management estimates that the total capital related costs of implementing the pollution control measures through 2006 will be approximately \$225 million; however, the cost estimate may change as additional information becomes available. The SIP also provides that the District shall develop a new SIP in 2003 to incorporate actual experience and to revise the schedule and plan as necessary to meet the air quality standards.

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, 2000.

Risk management

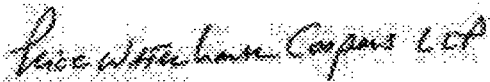
Water Services is subject to certain business risks common to the utility industry. The majority of these risks are mitigated by external insurance coverage obtained by Water Services. For other significant business risks, however, Water Services has elected to self-insure. It is management's belief that exposure to loss arising out of self-insured business risks will not materially affect Water Services' financial position as of June 30, 2000.

Credit risk

Financial instruments which potentially expose the Department to concentrations of credit risk consist primarily of accounts receivable from retail customers. The Department's customer base is concentrated among commercial, industrial, residential and governmental customers located within the City. Although the Department is directly affected by the City's economy, management does not believe significant credit risk exists at June 30, 2000 except as provided in the allowance for losses. The Department manages its credit exposure by requiring deposits from certain customers and through procedures designed to identify and monitor credit risk.

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

In our opinion, the accompanying balance sheets 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 the Power System (Energy Services) of the Department of Water and Power of the City of Los Angeles at June 30, 2000 and 1999, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2000 in conformity with accounting principles generally accepted in the United States of America. 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 auditing standards generally accepted in the United States of America, 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 our opinion.



Los Angeles, California
September 15, 2000

| (Amounts in thousands) | June 30, | |
|--|---------------------|---------------------|
| | 2000 | 1999 |
| ASSETS | | |
| Utility Plant | | |
| Generation | \$ 2,434,930 | \$ 2,425,760 |
| Transmission | 788,701 | 773,413 |
| Distribution | 3,469,367 | 3,351,081 |
| General | 814,281 | 796,680 |
| | <u>7,507,279</u> | <u>7,346,934</u> |
| Accumulated depreciation | 3,358,196 | 3,106,132 |
| | <u>4,149,083</u> | <u>4,240,802</u> |
| Construction work in progress | 80,224 | 103,280 |
| Nuclear fuel, at amortized cost | 12,274 | 11,562 |
| | <u>4,241,581</u> | <u>4,355,644</u> |
| Restricted and Other Investments | 1,385,349 | 1,769,642 |
| Current Assets | | |
| Cash and cash equivalents | 439,923 | 288,189 |
| Cash collateral received from securities lending transactions | 228,414 | 92,434 |
| Customer and other accounts receivable, net of \$11,000 and \$14,500 allowance for losses | 296,196 | 227,074 |
| Accrued unbilled revenue | 130,600 | 96,907 |
| Materials and fuel, at average cost | 91,222 | 94,135 |
| Prepayments and other current assets | 43,598 | 26,170 |
| | <u>1,229,953</u> | <u>824,909</u> |
| Long Term Notes Receivable | 1,118,617 | — |
| Net Pension Asset | 100,166 | 107,670 |
| | <u>\$ 8,075,666</u> | <u>\$ 7,057,865</u> |
| CAPITALIZATION AND LIABILITIES | | |
| Equity | | |
| Retained income reinvested in the business | \$ 2,763,566 | \$ 2,473,488 |
| Contributions in aid of construction | 295,257 | 280,792 |
| | <u>3,058,823</u> | <u>2,754,280</u> |
| Long-term Debt | 3,390,214 | 2,631,176 |
| Advance Refunding Bonds | 557,954 | 866,420 |
| | <u>7,006,991</u> | <u>6,251,876</u> |
| Current Liabilities | | |
| Debt due within one year | 136,165 | 136,685 |
| Accounts payable and accrued expenses | 149,418 | 121,828 |
| Accrued interest | 56,223 | 54,236 |
| Accrued employee expenses | 43,671 | 39,248 |
| Due to Water Services | 1,344 | 2,208 |
| Obligations under securities lending transactions | 228,414 | 92,434 |
| | <u>615,235</u> | <u>446,639</u> |
| Deferred Credits | 279,172 | 210,830 |
| Accrued Postretirement Liability | 174,268 | 148,520 |
| Commitments and Contingencies (Note 12) | — | — |
| | <u>\$ 8,075,666</u> | <u>\$ 7,057,865</u> |

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

Energy Services Statements of Income

| (Amounts in thousands) | Year Ended June 30, | | |
|--|---------------------|-------------------|-------------------|
| | 2000 | 1999 | 1998 |
| Operating Revenues | | | |
| Residential | \$ 641,196 | \$ 633,633 | \$ 625,696 |
| Commercial and industrial | 1,404,912 | 1,333,868 | 1,327,864 |
| Sales for resale | 297,845 | 184,667 | 53,342 |
| Other | 52,184 | 51,196 | 65,752 |
| Regulatory gain from rate restructuring | — | — | 90,262 |
| | <u>2,396,137</u> | <u>2,203,364</u> | <u>2,162,916</u> |
| Operating Expenses | | | |
| Fuel for generation | 326,008 | 213,030 | 158,705 |
| Purchased power | 707,333 | 797,743 | 770,507 |
| Other operating expenses | 407,376 | 378,398 | 396,092 |
| Maintenance | 141,031 | 142,748 | 168,352 |
| Depreciation | 264,027 | 257,072 | 245,117 |
| | <u>1,845,775</u> | <u>1,788,991</u> | <u>1,738,773</u> |
| Operating Income | <u>550,362</u> | <u>414,373</u> | <u>424,143</u> |
| Other Income and Expense | | | |
| Investment income | 100,213 | 46,197 | 41,400 |
| Loss on terminated power contract | (77,462) | — | — |
| Other, net | 2,846 | 11,401 | 28,197 |
| | <u>25,597</u> | <u>57,598</u> | <u>69,597</u> |
| Debt Expenses | | | |
| Interest on debt | 175,711 | 162,644 | 168,532 |
| Allowance for funds used during construction | (1,830) | (2,761) | (2,899) |
| | <u>173,881</u> | <u>159,883</u> | <u>165,633</u> |
| Net Income | <u>\$ 402,078</u> | <u>\$ 312,088</u> | <u>\$ 328,107</u> |

Statements of Retained Income Reinvested in the Business

| | Year Ended June 30, | | |
|---|---------------------|---------------------|---------------------|
| | 2000 | 1999 | 1998 |
| Balance at beginning of year | \$ 2,473,488 | \$ 2,269,546 | \$ 2,021,878 |
| Net income for the year | 402,078 | 312,088 | 328,107 |
| Less – Transfers to the reserve fund of the City of Los Angeles | 112,000 | 108,146 | 80,439 |
| Balance at end of year | <u>\$ 2,763,566</u> | <u>\$ 2,473,488</u> | <u>\$ 2,269,546</u> |

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

| (Amounts in thousands) | Year Ended June 30, | | |
|---|---------------------|-------------------|-------------------|
| | 2000 | 1999 | 1998 |
| Cash Flows from Operating Activities: | | | |
| Operating income | \$ 550,362 | \$ 414,373 | \$ 424,143 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | | |
| Depreciation | 264,027 | 257,072 | 245,117 |
| Provision for losses on customer and other accounts receivable | 10,778 | 16,763 | 14,581 |
| Loss from terminated power contract | (77,462) | — | — |
| Changes in assets and liabilities: | | | |
| Customer and other accounts receivable | (75,697) | (47,379) | (18,617) |
| Accrued unbilled revenue | (33,693) | 5,769 | 10,708 |
| Net pension asset | 7,504 | (24,758) | (60,361) |
| Accounts payable and accrued expenses | 27,590 | (44,791) | 44,256 |
| Overrecovered energy costs | — | — | (130,192) |
| Deferred credits | 68,342 | 85,972 | 63,750 |
| Accrued postretirement liability | 25,748 | 25,259 | 91,813 |
| Other | (8,110) | (15,540) | 22,106 |
| | <u>759,389</u> | <u>672,740</u> | <u>707,304</u> |
| Cash Flows from Noncapital Financing Activities: | | | |
| Payments to the reserve fund of the City of Los Angeles | (112,000) | (108,146) | (89,300) |
| Issuance of revenue bonds, net | 564,876 | — | — |
| Interest paid on noncapital revenue bonds | (7,405) | — | — |
| | <u>445,471</u> | <u>(108,146)</u> | <u>(89,300)</u> |
| Cash Flows from Capital and Related Financing Activities: | | | |
| Additions to plant and equipment, net | (148,134) | (145,482) | (137,725) |
| Contributions in aid of construction | 14,465 | 18,138 | 18,580 |
| Purchases of escrow investments | (49,651) | — | (227,447) |
| Proceeds from escrow investment maturities | 330,182 | 117,019 | 509,573 |
| Principal payments and maturities on long-term debt, net | (505,196) | (154,416) | (485,763) |
| Issuance of bonds and revenue certificates, net | 387,777 | 178,585 | 136,400 |
| Debt interest payments | (199,710) | (207,630) | (233,158) |
| | <u>(170,267)</u> | <u>(193,786)</u> | <u>(419,540)</u> |
| Cash Flows from Investing Activities: | | | |
| Purchases of investment securities | (221,211) | (1,855,227) | (1,258,105) |
| Proceeds from maturities of investment securities | 342,897 | 1,436,115 | 952,207 |
| Purchase of long-term notes receivable | (1,114,520) | — | — |
| Investment income | 109,975 | 80,236 | 81,636 |
| | <u>(882,859)</u> | <u>(338,876)</u> | <u>(224,262)</u> |
| Cash and Cash Equivalents: | | | |
| Net increase (decrease) | 151,734 | 31,932 | (25,798) |
| Beginning of year | 288,189 | 256,257 | 282,055 |
| | <u>\$ 439,923</u> | <u>\$ 288,189</u> | <u>\$ 256,257</u> |

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

NOTE 1: Summary of Significant Accounting Policies

The Department of Water and Power of the City of Los Angeles (the Department) exists as a separate proprietary agency of the City of Los Angeles (the City) under and by virtue of the City Charter enacted in 1925. The Department's Power System (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 accounting principles generally accepted in the United States of America. As a government-owned utility, the Department applies all statements issued by the Governmental Accounting Standards Board (GASB) and all statements and interpretations issued by the Financial Accounting Standards Board which are not in conflict with statements issued by the GASB. In addition, Energy Services' 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 in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, which requires 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. Management believes that Energy Services meets the criteria for continued application of SFAS No. 71, but will continue to evaluate its applicability based on changes in the regulatory and competitive environment (see Note 2).

Use of estimates – 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.

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 (AFUDC), 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 maintenance, repairs and minor replacements are charged to the appropriate operations and maintenance expense accounts. The original cost of property retired, net of removal and salvage costs, is charged to accumulated depreciation.

Depreciation – Depreciation expense is computed using the straight-line method based on service lives 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 July 1, 1973 is computed using the 5% sinking fund method based on estimated service lives. Estimated service lives range from 5 to 75 years. Depreciation expense as a percentage of average depreciable utility plant in service was 3.9%, 3.8% and 3.7% for fiscal years 2000, 1999 and 1998, respectively.

Nuclear decommissioning – The Department owns a 5.7% direct ownership interest in the Palo Verde Nuclear Generating Station (PVNGS). In addition, through its participation in the Southern California Public Power Authority (SCPPA), the Department owns an indirect interest of 3.95%. Costs associated with the Department's indirect interest are included in purchased power expense (see Note 4).

Decommissioning of PVNGS is expected to commence subsequent to the year 2024. The total cost to decommission the Department's direct ownership interest in PVNGS is estimated to be \$101 million in 1998 dollars. This estimate is based on an updated site specific study prepared by an independent consultant in 1998. Prior to fiscal year 2000, the Department contributed to external trusts established in accordance with the PVNGS participation agreement and Nuclear Regulatory Commission requirements. In both fiscal years 1999 and 1998, the Department contributed \$11 million to these trusts in order to fund its direct share of estimated decommissioning costs. These contributions were charged to depreciation expense.

During fiscal year 2000, the Department suspended contributing additional amounts to the trust funds, as management believes that contributions to date, combined with reinvested earnings, will be sufficient to fully fund the Department's share of decommissioning costs. The Department will continue to reinvest its investment income. As of June 30, 2000, decommissioning funds totaled approximately \$73 million.

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 assesses each utility with nuclear operations, including the Department, \$1 per megawatt hour of nuclear generation. The Department includes this charge as a current year expense. See Note 12 for discussion of spent nuclear fuel disposal.

Cash and cash equivalents – The Department's cash is deposited with the City Treasurer in the City's general investment pool. The City Treasurer invests available funds of the City and its independent operating departments on a combined basis. At both June 30, 2000 and 1999, cash and cash equivalents includes \$35 million of internally-designated balances relating to bond redemption and interest funds and a self-insurance fund. In addition, at June 30, 2000 and 1999, the cash and cash equivalents balance includes \$253 million and \$108 million, respectively, of funds restricted by bond indenture for use in construction. The Department considers all unrestricted investments with an original maturity of three months or less to be cash equivalents.

Investments – Investments include commercial paper, United States Government and governmental agency securities, and corporate bonds. Investments are reported at fair value and changes in unrealized gains and losses are recorded in the Statement of Income. Gains and losses realized on the sale of investments are generally determined using the specific identification method.

Debt expenses – Debt premium, discount and issue expenses are deferred and amortized to expense over the lives of the related debt issues. Gains and losses on refundings related to bonds redeemed by proceeds from the issuance of new bonds are amortized over the shorter of the life of the new bonds or the remaining term of the bonds refunded.

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 is shown in the accompanying balance sheet as a component of equity.

Revenues – Energy Services' rates are established by a rate ordinance which is approved by the City Council. Energy Services sells energy to other City departments at rates provided in the ordinance. Energy Services recognizes energy costs in the period incurred and accrues for estimated energy sold but not yet billed.

The Department's current rates include amounts designated for the precollection of out-of-market future purchase power costs. These amounts are included in deferred credits and will be recognized as revenue when the related purchase power expense is incurred. At June 30, 2000 and 1999, deferred credits include \$256 million and \$185 million, respectively, related to precollected purchased power costs.

Allowance for funds used during construction – Allowance for funds used during construction represents the cost of borrowed funds used for the construction of utility plant. Capitalized AFUDC is included as part of the cost of utility plant and as a reduction of debt expenses. The average AFUDC rate was 5.4%, 6.0% and 6.0% for the fiscal years 2000, 1999 and 1998, respectively.

Reclassification – Certain financial statement items for prior years have been reclassified to conform to the current year presentation.

NOTE 2: Regulatory Matters

Effective April 1, 1998, customers of California's investor-owned utilities (IOU) became eligible for direct access. The introduction of direct access resulted in significant structural changes to the electric power industry, including plant divestitures and management of IOU transmission assets through the California Independent System Operator (ISO).

As a government-owned utility, the Department was not compelled to participate in direct access or to divest its generation assets. Management continues to evaluate the Department's alternatives in response to deregulation, including potential rate decreases, the introduction of direct access and participation in the ISO. In addition, management has implemented debt and cost reduction programs and restructured certain purchase power commitments in response to the changes in the electric utility market. Furthermore, in August 2000, the City Council approved a \$1.7 billion, ten-year plan to upgrade the Department's local power plants and to implement a program that includes demand side management, alternative energy sources and distributed generation.

No definitive plan for allowing direct access to customers in the Department's service area has been adopted; however, if the Department implements direct access in the future, it is likely that its generation business will no longer qualify for accounting under SFAS No. 71. SFAS No. 71 requires that the effects of the rate making process be recorded in the financial statements. Based on current and projected market prices, management does not believe that market issues or the introduction of direct access will negatively impact the Department's financial position.

Public benefits

In accordance with Assembly Bill 1890, 2.85% of the Department's retail revenue is designated for use for qualifying public benefits programs. Qualifying programs include cost-effective demand side management services to promote energy-efficiency and energy conservation, new investment in renewable energy resources and technologies, development and demonstration programs to advance science and technology, and services provided for low-income electricity customers. During fiscal years 2000 and 1999, the Department spent \$61 and \$45 million, respectively, on public benefits programs including investments in electric buses and vehicles, photovoltaic power and support for low-income customers. The Department defers public benefits collections from customers in excess of costs incurred under qualifying programs. As of June 30, 2000 and 1999, the deferred credits balance includes public benefits deferrals of \$10 million and \$12 million, respectively.

Rate ordinance

Effective May 1, 1998, the City Council approved a new rate ordinance for Energy Services. The previous rate ordinance included an energy cost adjustment factor (ECAF) designed to permit the full recovery of current and future energy costs, funding requirements of nuclear plant decommissioning costs and the costs of funding certain conservation programs intended to reduce current and future energy consumption. The new rate ordinance froze the ECAF at the rate in effect as of October 1, 1997. Management believes that the frozen rates are adequate to cover future associated costs.

Regulatory Gain from Rate Restructuring – Under the previous rate ordinance, the Department estimated recoverable costs to establish the energy cost component of customer billings and any difference between billed and actual costs was deferred and recorded as a regulatory liability. The Department is no longer required to defer and offset these amounts in future billings; therefore, over-recovered costs of \$90 million were recognized as a regulatory gain on May 1, 1998. In accordance with the new ordinance, the Department transferred a related amount of cash to the debt reduction trust funds.

Deferred Credits – On January 2, 1991, pursuant to a City Rate Ordinance, the Department established an energy cost stabilization account with surplus construction funds received from the Intermountain Power Agency. These funds were used at the discretion of management to reduce purchased power costs. In accordance with the new rate ordinance, on May 1, 1998 the remaining balance of \$31 million was transferred from the energy cost stabilization account to the debt reduction trust funds. The related regulatory liability was recognized as an offset to purchased power expense.

NOTE 3: Jointly-Owned Utility Plant

Energy Services has direct interests in several electric generating stations and transmission systems which are jointly-owned with other utilities. As of June 30, 2000, utility plant includes the following amounts related to Energy Services' ownership interest in each jointly-owned utility plant (amounts in millions, except as indicated):

| | Ownership Interest | Share of Capacity (MW) | Plant in Service | |
|---------------------------------------|--------------------|------------------------|------------------|--------------------------|
| | | | Cost | Accumulated Depreciation |
| Palo Verde Nuclear Generating Station | 5.7% | 217 | \$ 510 | \$ 187 |
| Navajo Generating Station | 21.2% | 477 | 205 | 151 |
| Mohave Generating Station | 20.0% | 316 | 124 | 67 |
| Pacific Intertie DC Transmission Line | 40.0% | 1240 | 184 | 43 |
| Other transmission systems | Various | | 76 | 33 |
| | | | <u>\$ 1,099</u> | <u>\$ 481</u> |

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

On August 15, 2000, the Los Angeles City Council approved the sale of the Department's 20% ownership interest in Mohave Generating Station (Mohave) to AES Corporation (AES) for approximately \$190 million. The sale is expected to result in a gain of approximately \$130 million. Unless AES waives its rights in writing, completion of this transaction is subject to the closing of AES' purchase of Southern California Edison's 56% ownership interest in Mohave, which is pending final regulatory approval.

NOTE 4: Purchase Power Commitments

The Department has entered into a number of energy and transmission service contracts which involve substantial commitments as follows (amounts in millions, except as indicated):

| | Agency | Agency Share | Interest | Department's Interest in Agency's Share | |
|---------------------------------------|--------|--------------|----------|---|-----------------------|
| | | | | Capacity MW | Outstanding Principal |
| Intermountain Power Project | IPA | 100.0% | 66.8% | 1,068 | \$ 2,137 |
| Palo Verde Nuclear Generating Station | SCPPA | 5.9% | 67.0% | 151 | \$ 601 |
| Mead-Adelanto Project | SCPPA | 67.9% | 35.7% | 291 | \$ 98 |
| Mead-Phoenix Project | SCPPA | 17.8%-22.4% | 24.8% | 148 | \$ 22 |
| Southern Transmission System | SCPPA | 100.0% | 59.5% | 1,142 | \$ 653 |

IPA: The Intermountain Power Agency is an agency of the State of Utah established to own, acquire, construct, operate, maintain, and repair the Intermountain Power Project (IPP). Energy Services serves as the Project Manager and Operating Agent of IPP.

SCPPA: The Southern California Public Power Authority, a California Joint Powers Agency. Note: SCPPA's interest in the Mead-Phoenix Project includes three components.

The above agreements require Energy Services to make certain minimum payments, which are based mainly upon debt service requirements. In addition to average annual fixed charges of approximately \$340 million during each of the next five years, the Department is required to pay for operating and maintenance costs related to actual deliveries of energy under these agreements (averaging approximately \$210 million annually during each of the next five years). The Department made total payments under these agreements of approximately \$550, \$610, and \$620 million in fiscal years 2000, 1999 and 1998, respectively. These agreements are scheduled to expire from 2027 to 2030.

Long-term notes receivable – Under the terms of its purchase power agreement with IPA, the Department is responsible for its share of IPA's costs, including debt service. During fiscal year 2000, the Department restructured a portion of this obligation by transferring \$1.12 billion to IPA in exchange for long-term notes receivable. The funds transferred were obtained from the debt reduction trust funds and through the issuance of new variable rate debentures (see Notes 5 and 7). IPA used the proceeds from these transactions to defease and to tender for bonds with par values of approximately \$615 million and \$611 million, respectively. The net discount of \$114 million is being amortized using the effective interest method over the lives of the bonds through 2023.

This transaction did not impact the principal balance of IPA's debt outstanding as the long-term notes received by the Department represent subordinated obligations of IPA which are paid at the same interest rate and on the same maturity schedule as the original notes. In addition, the Department retains an obligation for its share of IPA's debt service; however, the Department's future payments will be partially offset by interest payments and principal maturities from the subordinated notes receivable.

On September 7, 2000, the Department transferred another \$187 million to IPA in exchange for additional long-term notes receivable. IPA used the proceeds to defease bonds with a face value of \$198 million.

Termination of power contract – During fiscal year 2000, the Department terminated a power contract with the Montana Power Company (Montana) under which the Department was required to take approximately 750,000 megawatt hours annually through 2010. The Department recorded a net loss of approximately \$77 million on this transaction.

Energy entitlement – The Department 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 \$10 million in fiscal years 2000, 1999 and 1998, respectively.

NOTE 5: Restricted and Other Investments

A summary of Energy Services' restricted and other investments is as follows (amounts in millions):

| | 2000 | June 30, 1999 |
|-------------------------------------|-----------------|------------------|
| Escrow investments | \$ 612 | \$ 871 |
| Debt reduction trust funds | 679 | 815 |
| Nuclear decommissioning trust funds | 73 | 69 |
| Other investments | 21 | 15 |
| | <u>\$ 1,385</u> | <u>\$ 1,770</u> |

All restricted and trust funds are held in accounts to be used for a designated purpose as follows:

Escrow investments – Escrow investments are held to call specified revenue bonds at scheduled maturity dates.

Debt reduction trust funds – The debt reduction trust funds were established during fiscal year 1997 to provide for the payment of principal and interest on long-term debt obligations and purchased power obligations arising from the Department's participation in the Intermountain Power Project and the Southern California Public Power Authority (see Note 4). Purchased power precollections are transferred to these accounts as amounts are collected from customers; funds from operations also may be transferred by management as funds become available.

Nuclear decommissioning trust funds – Nuclear decommissioning trust funds will be used to pay the Department's share of decommissioning the Palo Verde Nuclear Generating Station at the end of its useful life.

NOTE 6: Securities Lending Transactions

In December 1999, the Department initiated a securities lending program managed by its custodial bank. The bank lends up to 20% of the investments held in the debt reduction trust funds and decommissioning trust funds and plan assets held in the postretirement benefits trust fund for securities, cash collateral or letters of credit equal to 102% of the market value of the loaned securities and interest, if any. The Department can sell collateral securities only in the event of borrower default.

A summary of Energy Services' securities lending transactions as of June 30, 2000 is as follows (amounts in millions):

| Securities lent for cash collateral | Fair value of underlying securities | Collateral value |
|---------------------------------------|-------------------------------------|------------------|
| U.S. Government and agency securities | \$ 3 | \$ 3 |
| Corporate fixed income securities | 137 | 142 |
| | <u>\$ 140</u> | <u>\$ 145</u> |

The lending agent provides indemnification for borrower default. There were no violations of legal or contractual provisions and no borrower or lending agent default losses during the year.

General Investment Pool Program – The Department also participates in the City's securities lending program through the pooled investment fund. The City's program has substantially the same terms as the Department's direct securities lending program. The Department recognizes its proportionate share of the cash collateral received for securities loaned and the related obligation for the general investment pool. As of June 30, 2000 and 1999, Energy Services' attributed share of cash collateral and the related obligation from the City's program consisted of \$83 and \$92 million, respectively.

Management believes that participation in these securities lending programs results in no credit risk exposure to the Department because the amounts owed to the borrowers exceed the amounts borrowed.

NOTE 7: Long-term Debt and Advance Refunding Bonds

Long-term debt outstanding consists of revenue bonds and refunding revenue bonds due serially in varying annual amounts as follows (amounts in thousands):

| Bond Issues | Date of Issue | Effective Interest Rate | Fiscal Year of Last Scheduled Maturity | Principal Outstanding |
|---|---------------|-------------------------|--|-----------------------|
| Third Issue of 1971 | 11/01/71 | 4.859% | 2012 | \$ 19,800 |
| Issue of 1972 | 03/15/72 | 5.293% | 2012 | 15,600 |
| Third Issue of 1972 | 10/15/72 | 5.232% | 2013 | 21,450 |
| Issue of 1973 | 02/15/73 | 5.252% | 2013 | 21,450 |
| Second Issue of 1973 | 06/01/73 | 5.298% | 2013 | 20,410 |
| Second Issue of 1977 | 12/15/77 | 5.792% | 2018 | 27,200 |
| Second Issue of 1990 | 09/15/90 | 7.318% | 2031 | 93,300 |
| Issue of 1991 | 01/15/91 | 7.179% | 2031 | 142,200 |
| Second Issue of 1991 | 06/01/91 | 6.821% | 2031 | 94,800 |
| Third Issue of 1991 | 10/01/91 | 6.684% | 2032 | 144,900 |
| Refunding Issue of 1992 | 02/01/92 | 6.398% | 2028 | 160,255 |
| Issue of 1992 | 04/01/92 | 6.687% | 2032 | 144,900 |
| Second Issue of 1992 | 08/15/92 | 6.083% | 2033 | 123,000 |
| Issue of 1993 | 01/15/93 | 6.222% | 2033 | 196,700 |
| Refunding Issue of 1993 | 04/15/93 | 5.824% | 2031 | 564,200 |
| Second Issue of 1993 | 10/15/93 | 5.210% | 2034 | 114,110 |
| Second Refunding Issue of 1993 | 11/15/93 | 5.424% | 2032 | 542,005 |
| Refunding Issue of 1994 | 02/01/94 | 4.779% | 2019 | 70,240 |
| Issue of 1994 | 02/01/94 | 5.284% | 2034 | 77,305 |
| Issue of 1999 | 06/15/99 | 5.445% | 2029 | 180,000 |
| Issue of 2000 | 03/02/00 | 5.878% | 2030 | 336,905 |
| Second Issue of 2000 | 03/02/00 | Variable | 2010 | 620,600 |
| Total principal amount | | | | \$ 3,731,330 |
| Revenue certificates | | | | 388,500 |
| Unamortized debt-related costs (including net loss on refundings) | | | | (35,497) |
| Debt due within one year (including current portion of revenue certificates) | | | | (136,165) |
| | | | | <u>\$ 3,948,168</u> |

Revenue bonds generally are callable ten years after issuance. The Department has agreed to certain covenants with respect to bonded indebtedness. Significant covenants include 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. Revenue bonds and refunding bonds are secured by the future revenues of Energy Services.

New issuances

In March 2000, the Department issued \$337 and \$621 million of fixed and variable rate bonds, respectively. The net proceeds from these issuances were used as follows (amounts in thousands):

| | |
|--|-------------------|
| Deposits to construction funds | \$ 247,511 |
| Defeasance of selected revenue bonds | 85,871 |
| Purchase of long-term notes receivable | 564,876 |
| Tender for selected revenue bonds | 54,395 |
| | <u>\$ 952,653</u> |

A portion of the proceeds was used to tender for and to defease bonds with par amounts of \$58 and \$92 million, respectively. Based on an assumed costs of 4.0% for the variable rate bonds, the tender and defeasance are expected to reduce total debt payments over the life of the new issues by \$99 million and are expected to result in present value savings of approximately \$6 million. The actual savings will vary depending on future interest rates. An increase in the average rate of the variable bonds to 4.5% would change total net debt service savings to \$97 million and the present value savings to \$4 million. These transactions resulted in a net gain for accounting purposes of \$7 million which was deferred and will be amortized over the shorter of the life of the bonds retired or the life of the new bonds.

Variable rate bonds – The variable rate bonds currently bear interest at a weekly rate (4.25% as of June 30, 2000). The Department can elect to change the interest rate period of the bonds, with certain limitations. The bondholders have the right to tender the bonds to the tender agent on any business day with seven days prior notice. The Department has entered into Standby Agreements with a syndicate of commercial banks in an initial amount of \$621 million to provide liquidity for these bonds. The initial Standby Agreements expire on February 28, 2001. Bonds purchased under the agreements will bear interest that is payable quarterly at the greater of the Federal Funds Rate plus .50% or the bank's announced base rate, as defined. The unpaid principal of bonds purchased is payable in ten equal semi-annual installments, commencing after the termination of the agreement. At its discretion, the Department has the ability to convert the outstanding bonds to fixed rate obligations which cannot be tendered by the bondholders.

Escrow investments

In February 2000, the Department transferred \$51 million from the debt reduction trust funds to trusts established for the purpose of making future debt service payments on specified revenue bonds with a par value of \$54 million. The final maturity of the related revenue bonds is 2018.

Advanced refunding bonds – In prior years, Energy Services established irrevocable escrow trusts with proceeds from the issuance of refunding bonds. During fiscal year 2000, bonds with a par value of \$303 million were refunded using proceeds from the balance in the restricted escrow investments. Escrow investments of \$559 million (stated at fair value as of June 30, 2000) will be used to refund bonds presently included in long-term debt at scheduled redemption dates as follows (amounts in thousands):

| Bond Issues | Redemption Date | Principal Amount to be Redeemed |
|----------------------|-----------------|---------------------------------|
| Second Issue of 1990 | 09/15/00 | \$ 91,400 |
| Issue of 1991 | 01/15/01 | 139,200 |
| Second Issue of 1991 | 06/01/01 | 77,000 |
| Third Issue of 1991 | 10/01/01 | 122,100 |
| Issue of 1992 | 04/01/02 | 118,200 |
| | | <u>\$ 547,900</u> |

The related advance refunding bonds will be reclassified to long-term debt from advance refunding bonds at the time that the bonds to be refunded are called. Interest expense from refunding bonds and interest income earned on related escrow investments are included in investment income.

Scheduled principal maturities – Scheduled annual principal maturities during the five years following June 30, 2000 are \$56, \$87, \$97, \$181 and \$175 million, respectively. These scheduled maturities exclude the impact of mandatory redemptions with escrow investments.

Revenue certificates – As of June 30, 2000, the Department has outstanding commercial paper of \$389 million bearing interest at an average rate of 3.86%. The commercial paper matures not more than 162 days from the date of issuance. The Department intends and has the ability to refinance \$309 million of the outstanding revenue certificates upon their maturity and, therefore, has included this portion of the balance outstanding in long-term debt at June 30, 2000. The commercial paper is an unsecured obligation of the Department.

Effective September 1, 1999, the Department entered into a letter of credit and reimbursement agreement (the Agreement) with a commercial banking syndicate in the amount of \$400 million to provide liquidity and credit support for the Department's commercial paper program. The Agreement secures the payment when due of the principal and interest on commercial paper issued on or subsequent to September 1, 1999. Drawings on the Agreement will represent advances to the Department and will bear interest that is payable monthly at the Federal Funds Rate plus 0.5% or an adjusted rate based on the London Interbank Offered Rate (LIBOR), as defined. The unpaid principal of each advance is payable in ten equal semi-annual installments, commencing on the date six months after the advance. The Agreement terminates on August 31, 2002, unless extended.

Fair value – The fair value of long-term debt and refunding bonds is \$3.7 and \$3.4 billion at June 30, 2000 and 1999, respectively. Management has estimated fair value based on the present value of interest and principal payments on the long-term debt and refunding bonds, discounted using current interest rates obtainable by the Department for debt of similar quality and maturities.

The carrying amount of revenue certificates of \$389 million at June 30, 2000 and 1999 approximates fair value due to the short maturities of these instruments.

NOTE 8: Retirement, Disability and Death Benefit Insurance Plan

The Department has a funded contributory retirement, disability and death benefit insurance plan covering substantially all of its employees. The Water and Power Employees' Retirement, Disability and Death Benefit Insurance Plan (the Plan) operates as a single-employer benefit plan to provide pension benefits to eligible Department employees and to provide disability and death benefits from the respective insurance funds. Plan benefits are generally based on years of service, age at retirement and the employee's highest 12 consecutive months of salary before retirement. Active participants who joined the plan on or after June 1, 1984 are required to contribute 6% of their annual covered payroll. Participants who joined the plan prior to June 1, 1984 contribute an amount based upon an entry-age percentage rate. The Department contributes \$1.10 for each \$1.00 contributed by participants plus an actuarially determined annual required contribution as determined by the Plan's independent actuary. The contributions are allocated between Energy Services and Water Services based on the current year labor costs.

The Retirement Board of Administration (the Retirement Board) is the administrator of the Plan. The Plan 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 Board of Commissioners). The Plan is an independent pension trust fund of the Department.

Plan amendments must be approved by both the Retirement Board and the Board of Commissioners. During March 1998, two amendments were made to the Plan. The amendments change the retirement age required to receive unreduced benefits with thirty years of service from 55 to 50 years of age, and provide participants with the option of purchasing other governmental service for purposes of enhancing benefits and eligibility for retirement. These amendments are considered in the actuarial determination of annual required contributions.

Energy Services' allocated share of annual pension cost (APC) and net pension obligation (NPO) consists of the following (amounts in millions):

| | Year Ended June 30, 2000 | 1999 |
|---|-----------------------------|-----------------|
| Annual required contribution | \$ - | \$ - |
| Interest on net pension asset | (8) | (6) |
| Adjustment to annual required contribution | <u>34</u> | <u>21</u> |
| APC (including \$5 and \$3 million of amounts capitalized in fiscal 2000 and 1999, respectively) | 26 | 15 |
| Department contributions | (16) | (39) |
| Shared operating expenses (see Note 11) | <u>(2)</u> | <u>(1)</u> |
| Change in NPO | 8 | (25) |
| NPO (asset) at beginning of year | <u>(108)</u> | <u>(83)</u> |
| NPO (asset) at end of year | <u>\$ (100)</u> | <u>\$ (108)</u> |

Annual required contributions are determined through actuarial valuations using the entry age normal actuarial cost method. The actuarial value of assets in excess of the Department's actuarial accrued liability (AAL) is being amortized by level contribution offsets over the period ending June 30, 2003. As a result of an April 2000 amendment to the Plan, the amortization period will be changed to rolling fifteen-year periods effective July 1, 2000.

In accordance with actuarial valuations, the Department's required contribution rates are as follows:

| Actuarial Valuation Date June 30 | Normal Cost | Surplus Amortization | Contribution Rate |
|--|----------------|-------------------------|----------------------|
| 1999 | 10.57% | -26.72% | 0.00% |
| 1998 | 9.64% | -13.39% | 0.00% |
| 1997 | 9.14% | -1.82% | 7.32% |

The significant actuarial assumptions include an investment rate of return of 8%, projected inflation-adjusted salary increases of 5.5%, and postretirement benefit increases of 3%. The actuarial value of assets is determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period. Plan assets consist primarily of corporate and government bonds, common stocks, mortgage-backed securities and short-term investments.

Trend information for the current and two preceding fiscal years for Energy Services is as follows (amounts in millions):

| Year Ended June 30 | NPO | Percentage of APC Contributed | APC |
|-----------------------|----------|-------------------------------------|-------|
| 2000 | \$ (100) | 71% | \$ 26 |
| 1999 | \$ (108) | 285% | \$ 15 |
| 1998 | \$ (83) | 350% | \$ 26 |

The following schedule provides information about the Department's overall progress made in accumulating sufficient assets to pay benefits when due, prior to allocations to Water Services and Energy Services (amounts in millions):

| Actuarial Valuation Date June 30, | Actuarial Value of Assets | AAL | Actuarial Assets Over AAL | Funded Ratio | Covered Payroll | Overfunding as a % of Covered Payroll |
|--|---------------------------------|----------|------------------------------------|-----------------|--------------------|--|
| 1999 | \$ 5,254 | \$ 4,911 | \$ 343 | 107% | \$ 355 | 97% |
| 1998 | \$ 4,514 | \$ 4,340 | \$ 174 | 104% | \$ 431 | 40% |
| 1997 | \$ 3,851 | \$ 3,812 | \$ 39 | 101% | \$ 430 | 9% |

The Department's measurement, recognition and disclosure of pension information is in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*.

Disability and death benefits – Energy Services' allocated share of disability and death benefit plan costs and administrative expenses totaled \$9 million for each of the fiscal years 2000, 1999, and 1998.

NOTE 9: Health Care Costs

The Department provides certain health care benefits to active and retired employees and their dependents. The total number of active and retired Department participants entitled to receive benefits was approximately 15,000 at June 30, 2000. The allocated cost to Energy Services of providing such benefits amounted to \$78, \$73, and \$104 million for fiscal years 2000, 1999 and 1998, respectively. Of these costs, \$15, \$15, and \$20 million were capitalized and the remainder was charged to expense for fiscal years 2000, 1999 and 1998, respectively.

Postretirement benefits – The Department accounts for postretirement benefits in accordance with SFAS 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' allocated share of postretirement benefit costs is summarized as follows (amounts in millions):

| | Year Ended June 30, | | |
|---------------------------------------|---------------------|--------------|--------------|
| | 2000 | 1999 | 1998 |
| Service cost | \$ 8 | \$ 6 | \$ 8 |
| Interest cost | 30 | 23 | 23 |
| Expected return on plan assets | (3) | (3) | (3) |
| Amortization of transition obligation | 12 | 12 | 14 |
| Amortization of prior service costs | 5 | 2 | 1 |
| Curtailment loss | – | – | 28 |
| Special termination benefits | – | 7 | 8 |
| | <u>\$ 52</u> | <u>\$ 47</u> | <u>\$ 79</u> |

The funded status and the accrued benefit cost related to postretirement benefits for the Department, prior to allocations to Water Services and Energy Services, are summarized as follows (amounts in millions):

| | 2000 | June 30, 1999 |
|--|----------------|------------------|
| Change in benefit obligation: | | |
| Benefit obligation at beginning of year | \$ 513 | \$ 454 |
| Service cost | 10 | 8 |
| Interest cost | 39 | 30 |
| Actuarial losses (gains) | 58 | 37 |
| Plan amendment | 46 | — |
| Special termination benefits | — | 9 |
| Benefits paid | (30) | (25) |
| Benefit obligation at end of year | <u>636</u> | <u>513</u> |
| Change in fair value of plan assets: | | |
| Fair value of plan assets at beginning of year | 69 | 65 |
| Actual return on plan assets | <u>2</u> | <u>4</u> |
| Fair value of plan assets at end of year | <u>71</u> | <u>69</u> |
| Funded status | (565) | (444) |
| Unrecognized net loss (gain) | 63 | 4 |
| Unrecognized transition obligation | 197 | 212 |
| Unrecognized prior service cost | <u>62</u> | <u>23</u> |
| Accrued benefit cost | <u>\$(243)</u> | <u>\$(205)</u> |
| Energy Services' allocated share of accrued benefit cost | <u>\$(174)</u> | <u>\$(148)</u> |

Weighted average actuarial assumptions used in determining postretirement benefit costs are as follows:

| | 2000 | June 30, 1999 | 1998 |
|--------------------------------|-------|------------------|-------|
| Discount rate | 7.75% | 7.25% | 6.75% |
| Expected return on plan assets | 7.00% | 7.00% | 7.00% |

Plan assets consist primarily of short-term treasury obligations. No funding policy has been established for the future benefits to be provided under this plan.

For measurement purposes, an 8.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2000; the rate was assumed to decrease gradually to 5.75% in 2007 and remain at that level thereafter. The effect of a 1% change in these assumed health care cost trend rates would increase or decrease the Department's total benefit obligation by approximately \$78 million or \$71 million, respectively. In addition, such a 1% change would increase or decrease the aggregate service and interest cost components of net periodic benefit cost by approximately \$8 million.

During fiscal year 2000, the Department began contributing toward dental coverage for retirees enrolled in a Department-sponsored plan. This amendment resulted in a \$46 million increase in the Department's accumulated postretirement benefit obligation at June 30, 2000. Energy Services' allocated \$35 million share of this increase is being amortized through 2008, the remaining average service period. This change also resulted in an \$8 million increase in postretirement benefit costs for fiscal year 2000, of which \$6 million was allocated to Energy Services.

During fiscal year 1998, the Department implemented two changes in postretirement benefits to employees. The changes increased the subsidy rate applicable to retirees under age 65 with a spouse under age 65 and granted service credit years to employees and retirees with qualified service to other governmental organizations. These permanent changes resulted in a \$25 million increase in the Department's accumulated postretirement benefit obligation at June 30, 1998. Energy Services' allocated \$19 million share of this increase is being amortized through 2010, the remaining average service period.

The Department recognized curtailment and termination charges of \$9 and \$49 million during fiscal years 1999 and 1998, respectively, related to employees who accepted benefits under the Staff Reduction Program (see Note 10). Energy Services included its allocated share of these charges of \$7 and \$36 million related to fiscal years 1999 and 1998, respectively, in postretirement benefit costs.

NOTE 10: Staff Reduction Program

During fiscal year 1998, the Board of Commissioners approved the Staff Reduction Program (the SRP). The SRP was a voluntary program which offered monetary compensation or enhanced retirement benefits to employees during an acceptance period from June 1, 1998 to July 15, 1998.

The number of employee acceptances during the enrollment period was as follows:

| | Year Ended June 30, | |
|---------------------|---------------------|--------------|
| | 1999 | 1998 |
| Monetary benefits | 284 | 438 |
| Enhanced retirement | 502 | 839 |
| | <u>786</u> | <u>1,277</u> |

The cost of monetary benefits offered under the SRP was recognized in the fiscal year employees elected to accept the package. The Department's total cost of monetary benefits offered under the SRP was \$32 million, which included \$12 million and \$20 million related to employee acceptances in fiscal years 1999 and 1998, respectively. Energy Services included its \$7 million and \$15 million share of these costs for fiscal years 1999 and 1998, respectively, in other operating expenses. The cost of enhanced retirement benefits related to the SRP is considered in the determination of future actuarially required contributions to the retirement plan.

NOTE 11: 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 benefits provided. Operating expenses shared with Water Services were \$466, \$430, and \$440 million for fiscal years 2000, 1999 and 1998, respectively, of which \$316, \$284 and \$297 million were allocated to Energy Services.

NOTE 12: 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. 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 \$112 million in fiscal year 2000 from Energy Services to the reserve fund of the City. The Department expects to make a transfer declaration from Energy Services of approximately \$120 million during fiscal year 2001.

Palo Verde Nuclear Generating Station (PVNGS) – As a joint project participant in PVNGS, the Department has certain commitments with respect to nuclear spent fuel and waste disposal. Under the Nuclear Policy Act, the Department of Energy (DOE) was to develop the facilities necessary for the storage and disposal of spent fuel and to have the first such facility in operation by 1998; however, the DOE has announced that such a repository cannot be completed before 2010. There is ongoing litigation with respect to the DOE's ability to accept spent nuclear fuel; however, no permanent resolution has been reached.

Arizona Public Service (APS), PVNGS' operating agent, has capacity in existing fuel storage pools at PVNGS which, with certain modifications, could accommodate all fuel expected to be discharged from normal operation of PVNGS through 2002. In addition, APS believes it could augment that wet storage with new facilities for on-site storage of spent fuel for an indeterminate period of operation beyond 2002, subject to obtaining required government approvals. The Department currently estimates that it will incur \$23 million (in 1998 dollars) over the life of PVNGS for its direct share of the costs related to the on-site interim storage of spent nuclear fuel. During fiscal 1999, the Department expensed approximately \$7 million for its direct share of on-site interim nuclear fuel storage costs related to nuclear fuel burned prior to fiscal 1999. In addition, the Department began accruing for current nuclear fuel storage costs as a component of fuel expense as the fuel is burned. The Department's share of spent nuclear fuel costs related to its indirect interest in PVNGS is included in purchased power expense. APS currently believes that spent fuel storage or disposal methods will be available for use by PVNGS to allow its continued operation beyond 2002.

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 PVNGS currently insure potential claims and liability through commercial insurance with a \$200 million limit; the remainder of the potential liability is covered by the industry-wide retrospective assessment program provided under the Act. This program limits assessments to \$79 million for each licensee for each nuclear incident occurring at any nuclear reactor in the United States; payments under the program are limited to \$10 million per incident, per year. Based on the Department's 5.7% direct interest and its 3.95% indirect investment interest through SCPPA, the Department would be responsible for a maximum assessment of \$8 million per incident, limited to payments of \$1 million per incident annually.

Environmental matters – Numerous environmental laws and regulations affect Energy Services' facilities and operations. The Department monitors its compliance with laws and regulations and reviews its remediation obligations on an ongoing basis.

The Department is subject to the Regional Clean Air Incentives Market (RECLAIM) emission reduction program adopted by the South Coast Air Quality Management District (SCAQMD). In accordance with this program, an emissions cap is established for each company that controls emissions. Companies that exceed the required limit may buy emissions credits from other companies that have emissions below the maximum threshold. The Department has established a program of installing emission controls and purchasing RECLAIM trading credits to meet the emissions requirements.

Based on the Department's significant increase in sales for resale during the spring and the early summer of 2000, the Department anticipated a potential shortfall in nitrogen oxide emission credits to provide for both its native load and the demands of the California grid during the remaining months of calendar 2000. As a result, during August 2000, the Department entered into a Settlement Agreement (Agreement) with the SCAQMD. The Agreement releases the Department from any and all claims or penalties arising from the incidents which give rise to the RECLAIM violations at its local facilities through December 31, 2000. The Agreement also provides for a civil penalty of not less than \$14 million. The civil penalty must be spent within a three-year period on supplemental environmental projects agreed to by the SCAQMD and the Department.

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 Energy Services' financial position as of June 30, 2000.

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. Management believes that exposure to loss arising out of self-insured business risks will not materially affect Energy Services' financial position as of June 30, 2000.

Credit risk – Financial instruments which potentially expose the Department to concentrations of credit risk consist primarily of retail and wholesale receivables. The Department's retail customer base is concentrated among commercial, industrial, residential and governmental customers located within the City. Although the Department is directly affected by the City's economy, management does not believe significant credit risk exists at June 30, 2000, except as provided in the allowance for losses. The Department manages its credit exposure by requiring deposits from certain customers and through procedures designed to identify and monitor credit risk.

Energy Services also enters into forward purchase and sale commitments for the physical delivery of energy with utility companies and energy marketers. Energy Services is exposed to credit risk related to nonperformance by its wholesale counterparties under the terms of these contractual agreements. In order to limit the risk of counterparty default, the Department has implemented a Wholesale Marketing Counterparty Evaluation Policy (the Policy). The Policy includes provisions to limit risk including: the assignment of internal credit ratings to all Department counterparties based on counterparty and/or debt ratings; the requirement for credit enhancements (including irrevocable letters of credit, escrow trust accounts and parent company guarantees) for counterparties that do not meet an acceptable level of risk; and the use of standardized agreements which allow for the netting of positive and negative exposures associated with a single counterparty. Energy Services does not anticipate nonperformance by any of its counterparties and has no reserves related to nonperformance at June 30, 2000 and 1999, respectively. Energy Services did not experience any material counterparty default during fiscal years 2000, 1999 or 1998.

Water Services Selected Financial Data And Statistics

| (\$ Millions) | 2000 | 1999 | 1998 | Restated 1997 | Restated 1996 |
|--|--------------|--------------|--------------|------------------|------------------|
| Statement of Income | | | | | |
| Operating revenues | | | | | |
| Residential | \$ 207.9 | \$ 173.8 | \$ 159.4 | \$ 168.6 | \$ 166.6 |
| Multiple dwelling units | 153.4 | 139.2 | 135.1 | 128.0 | 132.5 |
| Commercial and industrial | 118.3 | 104.9 | 105.1 | 96.9 | 98.0 |
| Other | <u>30.6</u> | <u>25.5</u> | <u>25.5</u> | <u>24.7</u> | <u>25.8</u> |
| Total revenues | \$ 510.2 | \$ 443.4 | \$ 425.1 | \$ 418.2 | \$ 422.9 |
| Operating income | 156.6 | 135.0 | 105.1 | 120.5 | 142.8 |
| As % of revenues | 30.7% | 30.4% | 24.7% | 28.8% | 33.8% |
| Net Income | \$ 120.0 | \$ 94.1 | \$ 71.9 | \$ 82.5 | \$ 110.2 |
| Balance Sheet | | | | | |
| Net utility plant | \$ 2,314.7 | \$ 2,177.5 | \$ 2,087.7 | \$ 2,000.0 | \$ 1,896.1 |
| Capital additions, net | 206.5 | 155.6 | 151.1 | 163.8 | 157.8 |
| Capitalization | | | | | |
| Equity | 1,655.2 | 1,544.7 | 1,440.4 | 1,377.3 | 1,289.7 |
| Long-term debt | 709.5 | 633.8 | 652.6 | 668.4 | 682.4 |
| Advance refunding bonds | <u>316.0</u> | <u>314.2</u> | <u>138.7</u> | <u>153.1</u> | <u>170.2</u> |
| Total capitalization | 2,680.7 | 2,492.7 | 2,231.7 | 2,198.8 | 2,142.3 |
| Debt as % of net utility plant ^(A) | 30.7% | 29.1% | 31.3% | 33.4% | 36.0% |
| Interest on debt | 48.0 | 45.0 | 45.7 | 48.5 | 48.4 |
| Transfers to City of L.A. | 22.2 | 16.3 | 25.9 | 21.1 | 20.2 |
| Operations | | | | | |
| Gallons sold (billions) | 202.8 | 192.0 | 185.8 | 193.6 | 190.5 |
| Customers — average number (thousands) | 647.4 | 645.0 | 645.5 | 639.8 | 642.1 |
| Average revenue per hundred cu. ft. sold (in cents) | | | | | |
| Residential | 183.9 | 175.7 | 175.1 | 169.3 | 175.0 |
| Commercial and industrial | 183.3 | 166.7 | 168.4 | 160.0 | 162.8 |
| Water supply (billions of gallons) | | | | | |
| Local supply | 43.1 | 41.9 | 33.1 | 37.0 | 25.2 |
| DWP Aqueduct | 95.5 | 137.8 | 128.9 | 145.2 | 151.0 |
| Metropolitan Water District | <u>80.3</u> | <u>23.7</u> | <u>33.0</u> | <u>24.8</u> | <u>21.5</u> |
| Gross supply | 218.9 | 203.4 | 195.0 | 207.0 | 197.7 |
| Diversion from (to) local storage | <u>.7</u> | <u>(0.9)</u> | <u>(0.8)</u> | <u>(0.4)</u> | <u>0.9</u> |
| Net supply to distribution systems | <u>219.6</u> | <u>202.5</u> | <u>194.2</u> | <u>206.6</u> | <u>198.6</u> |

(A) Excludes revenue notes and advance refunding bonds

Energy Services Selected Financial Data and Statistics

| (\$ Millions) | 2000 | 1999 | 1998 | Restated 1997 | Restated 1996 |
|---|--------------|--------------|--------------|------------------|------------------|
| Statement of Income | | | | | |
| Operating revenues | | | | | |
| Residential | \$ 641.2 | \$ 633.6 | \$ 625.7 | \$ 599.9 | \$ 580.0 |
| Commercial and industrial | 1,404.9 | 1,333.9 | 1,327.9 | 1,303.7 | 1,275.9 |
| Sales for resale | 297.8 | 184.7 | 53.3 | 35.9 | 20.8 |
| Other | 52.2 | 51.2 | 65.8 | 77.6 | 70.2 |
| Regulatory gain from rate restructuring | <u>—</u> | <u>—</u> | <u>90.3</u> | <u>—</u> | <u>—</u> |
| Total revenues | \$ 2,396.1 | \$ 2,203.4 | \$ 2,163.0 | \$ 2,017.1 | \$ 1,946.9 |
| Operating income | 550.4 | 414.4 | 424.1 | 305.5 | 288.1 |
| As % of revenues | 23.0% | 18.8% | 19.6% | 15.1% | 14.8% |
| Net Income | \$ 402.1 | \$ 312.1 | \$ 328.1 | \$ 163.5 | \$ 97.7 |
| Balance Sheet | | | | | |
| Net utility plant | \$ 4,241.6 | \$ 4,355.6 | \$ 4,464.5 | \$ 4,569.0 | \$ 4,622.8 |
| Capital additions, net | 148.1 | 151.9 | 144.6 | 201.7 | 190.7 |
| Capitalization | | | | | |
| Equity | 3,058.8 | 2,754.3 | 2,532.2 | 2,265.9 | 2,180.9 |
| Long-term debt | 3,390.2 | 2,631.1 | 2,511.9 | 2,716.6 | 2,622.3 |
| Advance refunding bonds | <u>558.0</u> | <u>858.3</u> | <u>952.7</u> | <u>1,075.5</u> | <u>1,112.5</u> |
| Total capitalization | 7,007.0 | 6,243.7 | 5,996.8 | 6,058.0 | 5,915.7 |
| Debt as % of net utility plant ^(A) | 72.7% | 53.3% | 49.4% | 59.5% | 56.7% |
| Interest on debt | 175.7 | 162.6 | 168.5 | 179.5 | 181.2 |
| Transfers to City of L.A. | 112.0 | 108.1 | 80.4 | 97.3 | 59.9 |
| Operations | | | | | |
| Kilowatt hours sold (billions) | 27.7 | 26.2 | 22.9 | 23.0 | 22.2 |
| Customers — average number (thousands) | 1,433.4 | 1,386.0 | 1,370.1 | 1,358.0 | 1,350.8 |
| Average revenue per kWh sold (in cents) | | | | | |
| Residential | 10.1 | 9.8 | 10.0 | 9.7 | 9.6 |
| Commercial and industrial | 9.1 | 8.9 | 8.9 | 8.8 | 8.6 |
| Energy production (billion kWh) | | | | | |
| Hydro | 2.2 | 2.8 | 2.6 | 1.9 | 1.6 |
| Thermal | <u>16.0</u> | <u>13.1</u> | <u>9.9</u> | <u>8.7</u> | <u>9.1</u> |
| Total generation | 18.2 | 15.9 | 12.5 | 10.6 | 10.7 |
| Purchases | <u>12.7</u> | <u>13.3</u> | <u>14.1</u> | <u>15.4</u> | <u>14.5</u> |
| Total production | <u>30.9</u> | <u>29.2</u> | <u>26.6</u> | <u>26.0</u> | <u>25.2</u> |
| Net system capability (thousand megawatts) | | | | | |
| Hydro | .2 | 1.5 | 1.5 | 1.5 | 1.5 |
| Thermal | <u>3.2</u> | <u>3.2</u> | <u>3.2</u> | <u>3.2</u> | <u>3.2</u> |
| | 3.4 | 4.7 | 4.7 | 4.7 | 4.7 |
| Jointly-owned and firm purchases | <u>2.8</u> | <u>2.9</u> | <u>2.9</u> | <u>2.9</u> | <u>2.9</u> |
| | <u>6.2</u> | <u>7.6</u> | <u>7.6</u> | <u>7.6</u> | <u>7.6</u> |

(A) Excludes revenue notes and advance refunding bonds

Water Services Facts in Brief

| | 2000 | Year ended June 30, 1999 |
|--|-----------|-----------------------------|
| Use of Water | | |
| Average Los Angeles population served | 3,849,000 | 3,807,500 |
| Average daily use per capita (gallons) | 144.4 | 138.2 |
| Water sales for fiscal year (billion gallons) | 202.8 | 192.0 |
| Maximum daily demand (million gallons) | 763.9 | 780.7 |
| Water Supply (in billions of gallons) | | |
| Local supply (groundwater) | 43.1 | 41.9 |
| Los Angeles Aqueduct (Owens Valley) | 95.5 | 137.8 |
| Metropolitan Water District (California and Colorado River Aqueducts) | 80.3 | 23.7 |
| Gross supply | 218.9 | 203.4 |
| Diversion from (to) local storage | .7 | (0.9) |
| Net supply to distribution systems | 219.6 | 202.5 |

Energy Services Facts in Brief

| | 2000 | Year ended June 30, 1999 |
|--|----------------|-----------------------------|
| Number of Customers | | |
| Residential | 1,232,538 | 1,190,171 |
| Commercial | 180,321 | 174,489 |
| Industrial | 18,140 | 18,475 |
| All others | 2,428 | 3,097 |
| Total customers of all classes | 1,433,427 | 1,386,232 |
| Power Use | | |
| Sales to ultimate customers – kilowatt (kW) hours | 22,535,090,291 | 21,862,286,105 |
| Sales to other utilities – kW hours | 4,848,395,810 | 4,967,241,741 |
| Average annual kW hours per residential customer | 5,238 | 5,423 |
| Net dependable capacity, kilowatts | 6,956,300 | 7,061,300 |

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