



**LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM**

Financial Statements and
Required Supplementary Information

June 30, 2009 and 2008

(With Independent Auditors' Report Thereon)

**LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM**

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Independent Auditors' Report

The Board of Water and Power Commissioners
Department of Water and Power
City of Los Angeles:

We have audited the accompanying balance sheets of the City of Los Angeles' Department of Water and Power Power Revenue Fund (Power System), an enterprise fund of the City of Los Angeles, California, as of June 30, 2009 and 2008, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the Los Angeles Department of Water and Power's (the Department) management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Power System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1, the financial statements of the Power System are intended to present the financial position, and the changes in financial position and, cash flows of only that portion of the business-type activities and each major fund of the City of Los Angeles, California that is attributable to the transactions of the Power System. They do not purport to, and do not, present fairly the financial position of the City of Los Angeles, California as of June 30, 2009 and 2008, the changes in its financial position or its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Power System as of June 30, 2009 and 2008 and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 16, 2009 on our consideration of the Power System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal



control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis included on pages 3 through 12 and the schedules of funding progress for the pension plan and postemployment healthcare plan on page 65 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

November 17, 2009

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Management's Discussion and Analysis

June 30, 2009 and 2008

The following discussion and analysis of the financial performance of the City of Los Angeles' (the City) Department of Water and Power's (the Department) Power Revenue Fund (the Power System) provides an overview of the financial activities for the fiscal years ended June 30, 2009 and 2008. Descriptions and other details pertaining to the Power System are included in the notes to the financial statements. This discussion and analysis should be read in conjunction with the Power System's financial statements, which begin on page 13.

Using This Financial Report

This annual financial report consists of the Power System's financial statements and required supplementary information and reflects the self-supporting activities of the Power System that are funded primarily through the sale of energy, transmission, and distribution services to the public it serves.

Balance Sheets, Statements of Revenues, Expenses, and Changes in Fund Net Assets, and Statements of Cash Flows

The financial statements provide an indication of the Power System's financial health. The balance sheets include all of the Power System's assets and liabilities, using the accrual basis of accounting, as well as an indication about which assets can be utilized for general purposes, and which net assets are restricted as a result of bond covenants and other commitments. The statements of revenues, expenses, and changes in fund net assets report all of the revenues and expenses during the time periods indicated. The statements of cash flows report the cash provided by and used in operating activities, as well as other cash sources and uses, such as investment income and cash payments for bond principal and capital additions and betterments.

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The following table summarizes the financial condition and changes in fund net assets of the Power System as of and for the fiscal years ended June 30, 2009, 2008, and 2007:

Table 1 – Condensed Schedule of Assets, Liabilities, and Fund Net Assets

(Amounts in millions)

Assets	As of June 30		
	2009	2008	2007
Utility plant, net	\$ 6,617	6,212	5,923
Restricted investments	722	723	669
Other noncurrent assets	1,882	1,843	1,843
Current assets	1,771	2,007	1,535
	<u>\$ 10,992</u>	<u>10,785</u>	<u>9,970</u>
Liabilities and Fund Net Assets			
Long-term debt, net of current portion	\$ 5,242	4,802	4,183
Other long-term liabilities	542	567	756
Current liabilities	651	1,009	763
	<u>6,435</u>	<u>6,378</u>	<u>5,702</u>
Fund net assets:			
Invested in capital assets, net of related debt	1,251	1,489	1,582
Restricted	1,461	1,306	1,166
Unrestricted	1,845	1,612	1,520
	<u>4,557</u>	<u>4,407</u>	<u>4,268</u>
Total fund net assets	<u>\$ 10,992</u>	<u>10,785</u>	<u>9,970</u>

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Table 2 – Condensed Schedule of Revenues, Expenses, and Changes in Fund Net Assets

(Amounts in millions)

	Year ended June 30		
	2009	2008	2007
Operating revenue:			
Residential	\$ 888	884	818
Commercial and industrial	1,781	1,771	1,643
Sales for resale	51	90	103
Other	36	36	36
Total operating revenues	<u>2,756</u>	<u>2,781</u>	<u>2,600</u>
Operating expenses:			
Fuel for generation and purchased power	(1,149)	(1,338)	(1,245)
Maintenance and other operating expenses	(1,187)	(1,120)	(1,021)
Total operating expenses	<u>(2,336)</u>	<u>(2,458)</u>	<u>(2,266)</u>
Operating income	420	323	334
Nonoperating revenues (expenses):			
Investment income	115	159	153
Other nonoperating revenues and expenses, net	22	17	15
Debt expenses	(201)	(195)	(191)
Total nonoperating expense	<u>(64)</u>	<u>(19)</u>	<u>(23)</u>
Income before capital contributions and transfers	356	304	311
Capital contributions	17	17	20
Transfers to the reserve fund of the City of Los Angeles	(223)	(182)	(175)
Increase in fund net assets	150	139	156
Beginning balance of fund net assets	<u>4,407</u>	<u>4,268</u>	<u>4,112</u>
Ending balance of fund net assets	<u>\$ 4,557</u>	<u>4,407</u>	<u>4,268</u>

Assets

Utility Plant

During fiscal years 2009 and 2008, the Power System capitalized \$974 million and \$434 million of additions, respectively, including transfers from construction work in progress to utility plant in service. Of the \$974 million, \$394 million, or 40% is mostly related to distribution plant assets including poles, towers, fixtures, replacement of transformers, underground conductors, and conduit. The increase is attributable to our Power

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Reliability Program (PRP) to improve distribution system reliability. In addition, \$423 million or 43% is primarily related to generation plant assets including the cost to construct the Pinetree Wind Project and capital improvements to various generating stations. Of the \$434 million during fiscal year 2008, \$312 million, or 72% is related to distribution plant assets. Furthermore, the Power System had capital improvements to its utility plant assets to maintain and support normal load growth of the distribution and transmission systems.

Construction work in progress decreased by \$280 million in fiscal year 2009 and increased by \$116 million in fiscal year 2008. The 2009 decreases were mostly attributable to the capitalization of the Pinetree Wind Project, Towers and Overhead Transmission, Underground Transmission, and Distribution Facilities. The increase in 2008 was mostly attributable to the Pinetree Wind Project, Generation System, Underground Transmission, and Automated Meter Reading (AMR).

Additional information regarding the Power System's utility plant assets can be found in note 4 to the accompanying financial statements.

The Department's strategy is to have generating utility plant assets that can produce energy from a variety of fuel types. This is referred to as a hedged power supply. This is important in that if the costs related to a particular fuel type rise substantially in a short period of time, the Department can utilize its mix of generation assets to meet customer demand and to minimize increases in fuel expense. The Department is implementing a \$2.5 billion, Integrated Resource Plan 2007 (IRP) focusing on renewable power, greenhouse gas reduction, and energy efficiency through fiscal year 2015. The IRP is an energy resource planning document that provides a framework for assuring that the future energy needs of customers are reliably met in a cost-effective manner, and are consistent with the City's commitment to environmental leadership. Through June 30, 2009, the Department has incurred \$1.4 billion related to such upgrades.

The tables that follow summarize the generating resources available to the Department as of June 30, 2009. These resources include those owned by the Department (either solely or jointly with other utilities) as well as resources available through long-term purchase agreements. Generating station capacity is measured in megawatts (MWs).

Table 3 – Department-Owned Generation Facilities

Type of fuel	Number of facilities	Number of units	Net maximum capability (MWs)	Net dependable capability (MWs)
Natural Gas	4 ⁽¹⁾	22	3,415	3,339
Large Hydro	1	7 ⁽²⁾	1,247	1,175
Renewables	33	90 ⁽³⁾	227 ⁽⁴⁾	153
Subtotal	38	119	4,889	4,667
CDWR	—	—	(120) ⁽⁵⁾	(76)
Total	38	119	4,769	4,591

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- (1) Consists of the following generating stations: Harbor Station, Haynes Station, Scattergood Station, and Valley Station.
- (2) The Castaic Plant currently has six (1,075 MWs) out of seven units available due to ongoing modernization work scheduled to be completed by 2014.
- (3) The Department-owned renewable resources in-service include the Los Angeles Aqueduct, Owens Valley, and Owens Gorge small hydro units that qualify under the Department's renewable resource definition. Also included are microturbine units at the Lopez Canyon Landfill and Department built photovoltaic solar installations. This number does not include two of the Scattergood gas-fueled units that partially burn digester gas in which the output related to the digester gas also qualifies under the Department's renewable resource definition.
- (4) Includes 16 MWs of renewable energy generated at the Scattergood Station by burning digester gas from the Hyperion Treatment Plant.
- (5) Energy payable to the California Department of Water Resources (CDWR) for energy generated at the Castaic Plant. This amount varies weekly up to maximum of 120 MWs.

Table 4 – Jointly Owned and Contracted Facilities

Type	Number of facilities	Net maximum capability (MWs)	Net dependable capability (MWs)
Large Hydro	1	491 ⁽¹⁾	446
Nuclear	1	387 ⁽²⁾	381
Coal	3	1,679 ⁽³⁾	1,679
Renewables/DG	1,645 ⁽⁴⁾	356	112
Total	1,650	2,913	2,618

- (1) The Department's Hoover Plant contract entitlement is 25.16% of the Hoover total contingent capacity of 1,951 MWs. Current reduced lake level has reduced available capacity to about 446 MWs annual average.
- (2) The Department's Palo Verde Station (PVNGS) entitlement is 9.66% of the maximum net plant capability of 4,008 MWs.
- (3) The Department's current Intermountain Station (IPP) entitlement is 66.79% of the maximum net plant capability of 1,800 MW. A portion of the IPP entitlement is subject to variable recall. The Department's Navajo Station entitlement is 21.20% of the maximum net plant capability of 2,250 MWs. The Mohave Station generating units were removed from service at the end of 2005.
- (4) The Department's contracted renewable resources in-service include landfill gas units at various landfills in the Los Angeles area, hydro units locally and in British Columbia, Canada, wind farms in Wyoming and

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Oregon, customer solar photovoltaic installations locally, and Customer distributed generation (DG) units located in Los Angeles also provide energy resources.

Liabilities and Fund Net Assets

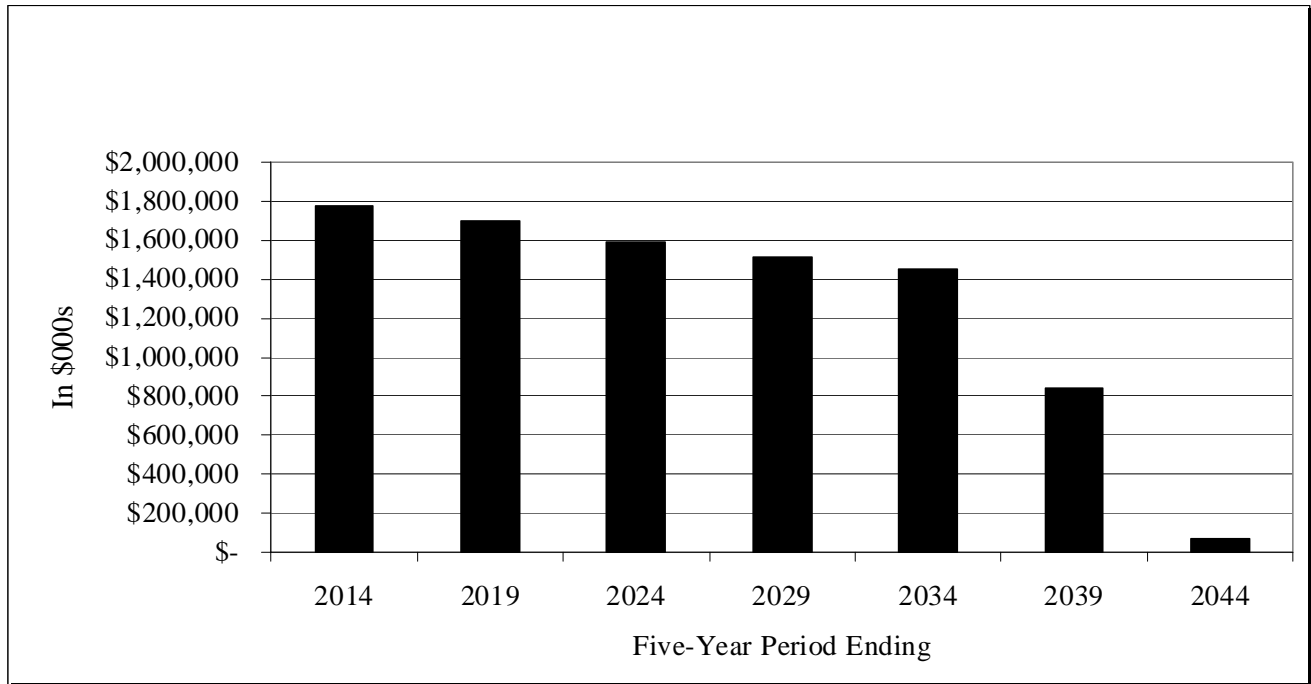
Long-Term Debt

As of June 30, 2009, the Power System's total outstanding long-term debt balance was approximately \$5.46 billion. The increase of \$480 million from the June 30, 2008 balance resulted from the sale of \$845 million of the Power System revenue bonds less the refunding of \$306 million revenue bonds and scheduled maturities of \$59 million.

As of June 30, 2008, the Power System's total outstanding long-term debt balance was approximately \$5.0 billion. The increase of \$611 million over the prior year resulted from the sale of \$654 million of the Power System revenue bonds and scheduled maturities of \$43 million.

Outstanding principal, plus scheduled interest as of June 30, 2009, is scheduled to mature as shown in the chart below:

Chart: Debt Service Requirements



As of June 30, 2009, \$46 million principal amount of long-term debt is considered defeased and remains outstanding. As of June 30, 2008, \$51 million principal amount of long-term debt is considered defeased and remains outstanding this debt, together with trust funds set aside for its full repayment at scheduled maturity dates, is not reflected on the balance sheet.

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In addition, the Power System had \$547 million and \$529 million on deposit in trust funds restricted for the use of debt reduction as of June 30, 2009 and 2008, respectively.

In May 2009, Standard & Poor's Rating Services, Moody's Investors Service, and Fitch Ratings affirmed the Power System's bond rating of AA-, Aa3, and AA-, respectively, due to the Power System's broad revenue stream and a competitive power supply portfolio, approval of the rate increases, and the City Council authorizing the unfreezing of the energy cost adjustment factor, which allows the Power System to fully recover changes in purchased power costs, fuel costs, and renewable resource costs. Additional information regarding the Power System's long-term debt can be found in note 10 to the financial statements.

Changes in Fund Net Assets

Operating Revenues

The operating revenues of the Power System are generated from wholesale and retail customers. There are four major customer categories of retail revenue. These categories include residential, commercial, industrial, and other, which includes public street lighting. Table 5 summarizes the percentage contribution of retail revenues from each customer segment in fiscal years 2009 and 2008:

Table 5 – Revenue and Percentage of Revenue by Customer Class

(Amounts in thousands)

	Fiscal year 2009		Fiscal year 2008	
	Revenue	Percentage	Revenue	Percentage
Type of customer:				
Residential	\$ 887,571	33%	\$ 883,503	33%
Commercial	1,554,721	58	1,535,554	57
Industrial	225,958	8	235,502	9
Other	36,802	1	36,390	1
	<u>\$ 2,705,052</u>	<u>100%</u>	<u>\$ 2,690,949</u>	<u>100%</u>

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While commercial customers consume the most electricity, residential customers represent the largest customer class. As of June 30, 2009 and 2008, the Power System had approximately 1.5 million customers. As shown in Table 6, 1.3 million, or 87%, of total customers were in the residential customer class.

Table 6 – Number of Customers and Percentage of Customers by Customer Class

(Numbers in thousands)

	Fiscal year 2009		Fiscal year 2008	
	Number	Percentage	Number	Percentage
Type of customer:				
Residential	1,258	87%	1,252	87%
Commercial	179	12	179	12
Industrial	13	1	13	1
Other	2	—	2	—
	<u>1,452</u>	<u>100%</u>	<u>1,446</u>	<u>100%</u>

Fiscal Year 2009

Retail revenues increased by \$14.1 million while wholesale revenues decreased by \$39.5 million from fiscal year 2008. The increase in retail revenue is due to an increase in base rates approved by the City Council in April 2008, offset by a decrease in costs that are recoverable through the energy cost adjustment billing factor. The decrease in wholesale revenue, which is comprised of energy and transmission sales is due to lower energy sales caused by milder weather. During fiscal years 2009 and 2008, the Power System deferred wholesale revenue of \$24.7 million and \$23.6 million to the rate stabilization account.

Fiscal Year 2008

Retail revenues increased by \$193.9 million while wholesale revenues decreased \$12.6 million from fiscal year 2007. The increase in retail revenue is due to a 1% increase in consumption, an increase in base rates approved by the City Council in April 2008, and an increase in costs that are recoverable through the energy cost adjustment billing factor. The decrease in wholesale revenue is due to the deferral of \$23.6 million to the rate stabilization account.

Operating Expenses

Fuel for generation and purchased power are two of the largest expenses that the Power System incurs each fiscal year. Fuel for generation expense includes the cost of fuel that is used to generate energy. The majority of fuel costs include the cost of natural gas, coal, and nuclear fuel.

Purchased power expense includes the cost of buying power on the open market and paying the current portion of the Power System's purchased power contracts. Under these purchase power contracts, the Department has an entitlement to the energy that is produced at various generating stations and an entitlement to the use of various transmission facilities. Most of these contracts require the Department to pay for these services regardless of whether the energy or transmission is used. These types of contracts are referred to as "take-or-pay" contracts.

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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. The Department uses the composite method of depreciation and, therefore, groups assets into composite groups for purposes of calculating depreciation expense. Estimated service lives range from 5 to 75 years. Amortization expense for computer software is computed using the straight-line method over five years.

The table below summarizes the Power System's operating expenses during fiscal years 2009 and 2008:

Table 7 – Operating Expenses and Percentage of Expense by Type of Expense

(Amounts in thousands)

	Fiscal year 2009		Fiscal year 2008	
	Expense	Percentage	Expense	Percentage
Type of expense:				
Fuel for generation	\$ 449,612	19%	\$ 647,814	26%
Purchased power	699,828	30	690,200	28
Other operating expenses	616,337	26	591,211	24
Maintenance	277,415	12	246,831	10
Depreciation and amortization	293,239	13	281,541	12
	<u>\$ 2,336,431</u>	<u>100%</u>	<u>\$ 2,457,597</u>	<u>100%</u>

Fiscal Year 2009

Fiscal year 2009 operating expenses were \$121 million lower as compared to fiscal year 2008. Fuel for generation expenses were \$198 million lower in fiscal year 2009 due to the decrease in the price of natural gas.

Other operating costs increased by \$25 million primarily in transmission expenses and hydraulic station expenses. Maintenance expense increased by \$31 million as compared to fiscal year 2008 due to maintenance of steam plant, transmission plant, and distribution plant. Other increases include depreciation and amortization expense by \$12 million, and purchased power increased by \$10 million.

Fiscal Year 2008

Fiscal year 2008 operating expenses were \$191 million higher as compared to fiscal year 2007. Fuel for generation expenses were \$103.0 million higher in fiscal year 2008 due to the increase in the price of natural gas.

Other operating costs increased by \$95 million with an offset in maintenance expense of \$8 million decrease, and depreciation expense increased by \$12 million as compared to fiscal year 2007. The increase in other operating costs was primarily due to \$45 million in distribution expenses, \$18 million in public benefits, \$13 million in administrative and general expenses, \$12 million in transmission expenses, and \$6 million in other production expenses. The decrease in maintenance costs was mostly related to distribution plant.

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Nonoperating Revenues and Expenses

Fiscal Year 2009

The major nonoperating activities of the Power System for fiscal year 2009 included the transfer of \$223 million to the City's General Fund, interest income earned on investments of \$115 million, and \$201 million in debt expenses.

The transfer to the City is based on 8% of the previous year's operating revenues. Operating revenues for fiscal year 2008 were \$2.8 billion, which generated a city transfer of \$223 million.

Interest income decreased by \$44 million due to less cash available for investing and a decline in the interest rates in fiscal year 2009 as compared to 2008.

The increase in debt expense is due to having 7 months of interest on the 2008 Series A1 debt that was issued in November 2008 offset by lower interest rates on variable rate debt. The variable rate bonds' daily and weekly rate range decreased from 1.55% to 1.65% as of June 30, 2008 to 0.27% to 0.30% as of June 30, 2009.

Fiscal Year 2008

The major nonoperating activities of the Power System for fiscal year 2008 included the transfer of \$182 million to the City's General Fund, interest income earned on investments of \$159 million, and \$196 million in debt expenses.

The transfer to the City is based on 7% of the previous year's operating revenues. Operating revenues for fiscal year 2007 were \$2.6 billion, which generated a city transfer of \$182 million.

Interest income increased by \$6.4 million due to more cash available for investing in fiscal year 2008 as compared to 2007.

The increase in debt expense is due to having 8.5 months of interest on the 2007 series debt that were issued October 2007 offset by lower interest rates on variable rate debt. The variable rate bonds' daily and weekly rate range decreased from 3.70% to 3.76% as of June 30, 2007 to 1.55% to 1.65% as of June 30, 2008.

Currently known Facts, Decisions, or Conditions

Although still subject to audit, the July 1, 2009 actuarial study for the Water and Power Employees' Retirement, Disability, and Death Benefit Insurance Plan (the Plan) noted the market value of the Plan's assets were approximately \$5.699 billion and the unfunded actuarial accrued liability was approximately \$808 million. The Plan had unrecognized investment losses of \$1.6 billion as of June 30, 2009. The Plan employs a 5-year smoothing technique to value assets in order to reduce the volatility in contribution rates. The impact of this will result in "smoothed" assets that are lower or higher than the market value of the assets depending upon whether the remaining amount to be smoothed is either a net gain or a net loss. If the unrecognized investments losses were recognized immediately, required contributions to the Plan would increase from approximately 26.12% of covered payroll to 48.57% of covered payroll. Additionally, if the unrecognized investments losses were recognized immediately in the actuarial value of assets, the funded ratio of the Plan would decrease from 90% to 70%.

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Balance Sheets

June 30, 2009 and 2008

(Amounts in thousands)

Assets	<u>2009</u>	<u>2008</u>
Noncurrent assets:		
Utility plant:		
Generation	\$ 3,935,518	3,514,113
Transmission	952,730	877,550
Distribution	5,146,367	4,755,330
General	1,112,554	1,033,043
	<u>11,147,169</u>	<u>10,180,036</u>
Accumulated depreciation	<u>(5,400,163)</u>	<u>(5,119,238)</u>
	5,747,006	5,060,798
Construction work in progress	609,115	889,226
Nuclear fuel, at amortized cost	36,904	32,982
Natural gas field, net	223,617	228,824
	<u>6,616,642</u>	<u>6,211,830</u>
Restricted investments	722,074	723,346
Long-term California wholesale energy receivable, net	116,333	116,333
Long-term notes and other receivables, net of current portion	1,079,866	1,107,510
Deferred debits	160,000	160,000
Net pension asset	70,644	77,479
Net postemployment asset	455,961	381,462
Total noncurrent assets	<u>9,221,520</u>	<u>8,777,960</u>
Current assets:		
Cash and cash equivalents – unrestricted	444,676	389,529
Cash and cash equivalents – restricted	409,863	494,512
Cash collateral received from securities lending transactions	8,591	239,703
Customer and other accounts receivable, net of \$14,000 and \$14,555 allowance for losses in 2009 and 2008, respectively	310,908	323,238
Current portion of long-term notes receivable	31,166	14,032
Accrued unbilled revenue	145,676	153,585
Due from Water System	9,903	—
Under recovered costs	130,367	190,609
Materials and fuel	153,218	134,847
Prepayments and other current assets	126,243	67,504
Total current assets	<u>1,770,611</u>	<u>2,007,559</u>
Total assets	<u>\$ 10,992,131</u>	<u>10,785,519</u>

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(Amounts in thousands)

Fund Net Assets and Liabilities	2009	2008
Fund net assets:		
Invested in capital assets, net of related debt	\$ 1,251,426	1,489,096
Restricted:		
Debt service	650,303	593,283
Capital projects	113,923	110,234
Other postemployment benefits	455,961	381,462
Pension benefits	70,644	77,479
Other purposes	170,262	143,604
Unrestricted	1,844,792	1,612,382
Total fund net assets	4,557,311	4,407,540
Long-term debt, net of current portion	5,241,853	4,801,728
Other noncurrent liabilities:		
Accrued liabilities	23,760	31,340
Deferred credits	488,821	503,436
Accrued workers' compensation claims	29,128	32,089
Total other noncurrent liabilities	541,709	566,865
Current liabilities:		
Current portion of long-term debt	217,882	175,455
Accounts payable and accrued expenses	235,922	411,006
Accrued interest	101,721	90,682
Accrued employee expenses	87,142	74,090
Due to Water System	—	18,450
Obligation under securities lending transactions	8,591	239,703
Total current liabilities	651,258	1,009,386
Total liabilities	6,434,820	6,377,979
Total liabilities and fund net assets	\$ 10,992,131	10,785,519

See accompanying notes to financial statements.

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Statements of Revenues, Expenses, and Changes in Fund Net Assets

Years ended June 30, 2009 and 2008

(Amounts in thousands)

	<u>2009</u>	<u>2008</u>
Operating revenues:		
Residential	\$ 887,571	883,503
Commercial and industrial	1,780,679	1,771,056
Sales for resale	50,883	90,375
Other	52,865	49,043
Uncollectible accounts	(16,063)	(12,653)
	<u>2,755,935</u>	<u>2,781,324</u>
Operating expenses:		
Fuel for generation	449,612	647,814
Purchased power	699,828	690,200
Maintenance and other operating expenses	893,752	838,042
Depreciation and amortization	293,239	281,541
	<u>2,336,431</u>	<u>2,457,597</u>
Operating income	<u>419,504</u>	<u>323,727</u>
Nonoperating revenues (expenses):		
Investment income	115,241	159,334
Other nonoperating income	28,309	22,035
	<u>143,550</u>	<u>181,369</u>
Other nonoperating expenses	(6,291)	(5,463)
	<u>137,259</u>	<u>175,906</u>
Debt expenses:		
Interest on debt	215,447	210,468
Allowance for funds used during construction	(14,137)	(14,894)
	<u>201,310</u>	<u>195,574</u>
Income before capital contributions and transfers	355,453	304,059
Capital contributions	16,824	17,601
Transfers to the reserve fund of the City of Los Angeles	(222,506)	(182,004)
Increase in fund net assets	149,771	139,656
Fund net assets:		
Beginning of year	4,407,540	4,267,884
End of year	<u>\$ 4,557,311</u>	<u>4,407,540</u>

See accompanying notes to financial statements.

**LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM**

Statements of Cash Flows

Years ended June 30, 2009 and 2008

(Amounts in thousands)

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Cash receipts:		
Cash receipts from customers	\$ 2,828,194	2,553,451
Cash receipts from customers for other agency services	524,672	463,001
Cash receipts from interfund services provided	367,072	416,442
Other cash receipts	97,209	23,603
Cash disbursements:		
Cash payments to employees	(492,701)	(464,543)
Cash payments to suppliers	(1,779,634)	(1,622,551)
Cash payments for interfund services used	(457,367)	(448,367)
Cash payments to other agencies for fees collected	(529,651)	(451,848)
Other cash payments	(130,147)	—
Total cash flows provided by operating activities	<u>427,647</u>	<u>469,188</u>
Cash flows from noncapital financing activities:		
Payments to the reserve fund of the City of Los Angeles	(222,506)	(182,004)
Payments to the Retiree Health Benefits Fund	—	(68,000)
Interest paid on noncapital revenue bonds	(5,648)	(14,182)
Total cash flows used for noncapital financing activities	<u>(228,154)</u>	<u>(264,186)</u>
Cash flows from capital and related financing activities:		
Additions to plant and equipment	(674,141)	(568,469)
Capital contributions	22,270	24,425
Principal payments and maturities on long-term debt	(364,902)	(43,033)
Proceeds from issuance of bonds and revenue certificates	845,446	674,136
Debt interest payments	(199,938)	(184,326)
Total cash flows used for capital and related financing activities	<u>(371,265)</u>	<u>(97,267)</u>
Cash flows from investing activities:		
Purchases of investment securities	(1,214,337)	(1,299,739)
Sales and maturities of investment securities	1,215,609	1,245,102
Proceeds from notes receivable	14,032	31,778
Investment income	126,966	153,389
Total cash flows provided by investing activities	<u>142,270</u>	<u>130,530</u>
Net increase (decrease)	(29,502)	238,265
Cash and cash equivalents:		
Cash and cash equivalents at July 1 (including \$494,512 and \$196,959 reported in restricted accounts, respectively)	<u>884,041</u>	<u>645,776</u>
Cash and cash equivalents at June 30 (including \$409,863 and \$494,512 reported in restricted accounts, respectively)	<u>\$ 854,539</u>	<u>884,041</u>

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Statements of Cash Flows

Years ended June 30, 2009 and 2008

(Amounts in thousands)

	<u>2009</u>	<u>2008</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 419,504	323,727
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	293,239	281,541
Depletion expenses	6,821	7,411
Amortization of nuclear fuel	6,717	5,668
Provision for losses on customer and other accounts receivable	16,063	12,653
Changes in assets and liabilities:		
Customer and other accounts receivable	(24,426)	(58,267)
Accrued unbilled revenue	7,909	(6,250)
Under recovered costs	60,242	(171,228)
Due from Water System	(9,903)	—
Materials and fuel	(18,372)	(16,497)
Deferred debits	—	68,181
Net pension asset	6,835	7,231
Accounts payable and accrued expenses for operating	(198,442)	212,170
Accrued liabilities	(7,580)	(196,841)
Deferred credits	(14,615)	3,759
Due to Water System	(18,450)	14,605
Net other postemployment asset	(74,499)	(17,409)
Workers' compensation liability and other	(23,396)	(1,266)
Net cash provided by operating activities	\$ <u>427,647</u>	<u>469,188</u>

See accompanying notes to financial statements.

LOS ANGELES DEPARTMENT OF WATER AND POWER POWER SYSTEM

Notes to Financial Statements

June 30, 2009 and 2008

(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 department of the City of Los Angeles (the City) under and by virtue of the City Charter enacted in 1925 and as revised effective July 2000. The Department's Power Revenue Fund (the Power System) is responsible for the generation, transmission, and distribution of electric power for sale in the City. The Power System is operated as an enterprise fund of the City.

(a) *Method of Accounting*

The accounting records of the Power System are maintained in accordance with U.S. generally accepted accounting principles (GAAP) for governmental entities. The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Prior to fiscal year 2003, the Department applied all statements issued by the Governmental Accounting Standards Board (GASB) and all statements and interpretations issued by the Financial Accounting Standards Board (FASB), which are not in conflict with statements issued by the GASB. In fiscal year 2003, the Department changed its election under the guidance in GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting* (GASB No. 20), to follow GASB statements and only FASB statements and interpretations issued on or before November 30, 1989.

The Department's rates are determined by the Board of Water and Power Commissioners (the Board) and are subject to review and approval by the City Council. As a regulated enterprise, the Department utilizes Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, which requires that the effects of the rate-making process be recorded in the financial statements. Such effects primarily concern the time at which various items enter into the determination of changes in fund net assets. Accordingly, the Power System records various regulatory assets and liabilities to reflect the Board's actions. Regulatory liabilities are recorded in deferred credits and regulatory assets are included as deferred debits and under recovered costs on the balance sheets. Management believes that the Power System 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 notes 3 and 14(d)ii).

(b) *Use of Estimates*

The preparation of financial statements in conformity with GAAP 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.

(c) *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, healthcare costs, and certain administrative and general

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expenses. The costs of maintenance, repairs, and minor replacements are charged to the appropriate operations and maintenance expense accounts.

(d) *Impairment of Long-Lived Assets*

The Department follows GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* (GASB No. 42). Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. Under GASB No. 42, impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the cause of the diminished service utility of the capital asset.

(e) *Depreciation and Amortization*

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 5.0% sinking fund method based on estimated service lives. The Department uses the composite method of depreciation and, therefore, groups assets into composite groups for purposes of calculating depreciation expense. Estimated service lives range from 5 to 75 years. Amortization expense for computer software is computed using the straight-line method over five years. Depreciation and amortization expense as a percentage of average depreciable utility plant in service was 2.8% for both fiscal years 2009 and 2008.

(f) *Nuclear Decommissioning*

The Department owns a 5.70% 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 is party to a contract for an additional 3.95% of the output of PVNGS. Nuclear decommissioning costs associated with the Power System's output entitlement are included in purchased power expense (see note 6).

Decommissioning of PVNGS is expected to commence subsequent to the year 2024. The total cost to decommission the Power System's direct ownership interest in PVNGS is estimated to be \$123 million in 2008 dollars. This estimate is based on an updated site-specific study prepared by an independent consultant in 2007. As of June 30, 2009 and 2008, the Power System has recorded \$133.5 million and \$129.8 million, respectively, to accumulated depreciation to provide for the decommissioning liability.

Prior to December 1999, the Power System contributed \$70.2 million to external trusts established in accordance with the PVNGS participation agreement and Nuclear Regulatory Commission requirements. During fiscal year 2000, the Department suspended contributing additional amounts to the trust funds, as management believes that contributions made, combined with reinvested earnings,

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will be sufficient to fully fund the Department's share of decommissioning costs. The Department will continue to reinvest its investment income on the trust investments into the decommissioning trusts. The Department reinvested \$3.7 million and \$7.4 million of investment income in fiscal years 2009 and 2008, respectively. Decommissioning funds, which are included in restricted investments, totaled \$113.9 million and \$110.2 million as of June 30, 2009 and 2008 (at fair value), respectively. The Department's current accounting policy recognizes any realized and unrealized investment earnings from nuclear decommissioning trust funds as a component of accumulated depreciation.

(g) *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 Power System, \$1 per megawatt hour of nuclear generation. The Power System includes this charge as a current year expense in fuel for generation. See note 14 for discussion of spent nuclear fuel disposal.

(h) *Natural Gas Field*

In July 2005, the Power System acquired approximately a 74.5% ownership interest in gas properties located in Pinedale, Wyoming. The Power System uses the successful efforts method of accounting for its investment in gas producing properties. Costs to acquire the mineral interest in gas producing properties, to drill and equip exploratory wells that find proven reserves, and to drill and equip development wells are capitalized. Costs to drill exploratory wells that do not find proven reserves are expensed. Capitalized costs of gas producing properties are depleted by the unit-of-production method based on the estimated future production of the proved developed producing wells.

Depletion expense related to the gas field is recorded as a component of fuel for generation expense. During fiscal years 2009 and 2008, the Power System recorded \$6.8 million and \$7.4 million of depletion expense, respectively.

(i) *Cash and Cash Equivalents*

As provided for by the State of California Government Code (the Code), the Power System's cash is deposited with the City Treasurer in the City's general investment pool for the purpose of maximizing interest earnings through pooled investment activities. Cash and cash equivalents in the City's general investment pool are reported at fair value and changes in unrealized gains and losses are recorded in the statements of revenues, expenses, and changes in fund net assets. Interest earned on such pooled investments is allocated to the participating funds based on each fund's average daily cash balance during the allocation period. The City Treasurer invests available funds of the City and its independent operating departments on a combined basis. The Power System classifies all cash and cash equivalents that are restricted either by creditors, the Board, or by law, as restricted cash and cash equivalents on the balance sheets. The Power System considers its portion of pooled investments in the City's pool to be cash and cash equivalents.

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At June 30, 2009 and 2008, restricted cash and cash equivalents include the following (amounts in thousands):

	June 30	
	2009	2008
Bond redemption and interest funds	\$ 203,250	153,485
Construction funds	94,519	254,449
Self-insurance fund	109,394	83,878
Other	2,700	2,700
	<u>\$ 409,863</u>	<u>494,512</u>

(j) Materials and Fuel

Materials and supplies are recorded at average cost. Fuel is recorded at lower of cost or market, on an average cost basis.

(k) Accrued Unbilled Revenue

Accrued unbilled revenue is the receivable for estimated energy sales during the period for which the customer has not been billed.

(l) Restricted Investments

Restricted investments include primarily commercial paper, U.S. 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 statements of revenues, expenses, and changes in fund net assets except for Nuclear Decommissioning Trust Funds. The stated fair value of investments is generally based on published market prices or quotations from major investment dealers (see note 7).

(m) Accrued Employee Expenses

Accrued employee expenses include accrued payroll and an estimated liability for vacation leave, sick leave, and compensatory time, which is accrued when employees earn the rights to the benefits. Below is a schedule of accrued employee expenses as of June 30, 2009 and 2008 (amounts in thousands):

	2009	2008
Type of expenses:		
Accrued payroll	\$ 17,494	12,793
Accrued vacation	46,061	40,992
Accrued sick leave	10,792	9,433
Compensatory time	12,795	10,872
Total	<u>\$ 87,142</u>	<u>74,090</u>

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(n) Debt Expenses

Debt premium, discount, and issue expenses are deferred and amortized to debt expense using the effective-interest method 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 to debt expense using the effective-interest method over the shorter of the life of the new bonds or the remaining term of the bonds refunded.

(o) Gas and Electricity Option and Location Swap Agreements

Gas and electricity option and location swap agreements are accounted for on a settlement basis (see note 9).

(p) Accrued Workers' Compensation Claims

Liabilities for unpaid workers' compensation claims are recorded at their net present value, (see note 13).

(q) Customer Deposits

Customer deposits represent deposits collected from customers upon opening of new accounts. These deposits are obtained when the customer does not have a previously established credit history with the Department. Original deposits plus interest are paid to the customer once a satisfactory payment history is maintained, generally after one to three years.

The Water System is responsible for collection, maintenance, and refunding of these deposits for all the Department customers, including those of the Power System. As such, the Water System's balance sheets include a deposit liability of \$74 million and \$77 million as of June 30, 2009 and 2008, respectively, for all customer deposits collected. In the event that the Water System defaults on refunds of such deposits, the Power System would be required to pay amounts it owes its customers.

(r) Revenues

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

Effective October 1, 2006, the Energy Cost Adjustment Factor (ECAF), which is a billing factor defined in the electric rate ordinance was unfrozen. This change allows the Power System to increase or decrease the factor on a quarterly basis in compliance with the ordinance. While this change allows the Power System to fully recover fuel costs, purchased power costs, and other costs outlined in the ordinance, the difference between the amount billed to customers, and the value of the costs allowed to be recovered through the factor create an over/under recovered amount. Costs that are under recovered will be recovered in future periods. Amounts over recovered will be factored into future quarterly rates. As of June 30, 2009 and 2008, the amount of under recovered costs, including the ECAF and the Reliability Cost Adjustment Factor was \$130.4 million and \$190.6 million, respectively. These balances are recorded as current assets on the balance sheets.

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Operating revenues are revenues derived from activities that are billable in accordance with the electric rate ordinance approved by the City Council.

(s) Capital Contributions

Capital contributions and other grants received by the Department for constructing utility plant and other activities are recognized when all applicable eligibility requirements, including time requirements, are met.

(t) Allowance for Funds Used During Construction (AFUDC)

An AFUDC charge 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. As of June 30, 2009 and 2008, the average AFUDC rates were 4.5% and 4.4%, respectively.

(u) Use of Restricted and Unrestricted Resources

The Power System's policy is to use unrestricted resources prior to restricted resources to meet expenses to the extent that it is prudent from an operational perspective. Once it is not prudent, restricted resources will be utilized to meet intended obligations.

(2) Recent Accounting Pronouncements

(a) GASB Statement No. 48

In September 2006, the GASB issued Statement No. 48, *Board Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* (GASB No. 48). This statement establishes criteria that governments will use to ascertain whether the proceeds received from an exchange of an interest in expected cash flows for immediate cash payments should be reported as revenue or as a liability. The Department has determined that this statement and the expanded disclosures of pledged revenues does not apply to its stand-alone financial statements as its operations are financed primarily by a single major revenue source.

(b) GASB Statement No. 49

In fiscal year 2009, the Department adopted GASB Statement No. 49, *Accounting and Financial Reporting for Pollution and Remediation Obligations* (GASB No. 49). This statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the statement excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and post closure care and nuclear power plant decommissioning. Prior to adopting this statement the Department followed Statement of Position 96-1, *Environmental Remediation Liabilities*. The Power System has identified sites that require remediation work and is working with the Department of Toxic Substances and the Los Angeles Regional Water Quality Control Board who have jurisdiction over these sites. The Power System's estimated liability for

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these sites is approximately \$15 million and includes remediation and ongoing operation and maintenance costs where estimable. This estimate includes recoveries of approximately \$18 million. During fiscal year 2009, the Power System set up a restricted trust fund in the amount of \$2.1 million to provide financial assurance for closure of one of its sites. The Power System's environmental liability is recorded as part of accrued expenses. There was no impact to Net Assets as of July 1, 2008 as a result of implementation of this pronouncement.

(c) GASB Statement No. 50

In May 2007, the GASB issued Statement No. 50, *Pension Disclosures, an amendment to GASB Statements No. 25 and No. 27* (GASB No. 50). This statement more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits (OPEB) and, in doing so, enhances information disclosed in notes to the financial statements or presented as required supplementary information (RSI) by pension plans and by employers that provide pension benefits. The reporting changes required by this statement amend applicable note disclosures and RSI requirements of GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, to conform to requirements of GASB Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The Department has implemented these disclosures in fiscal year 2008.

(d) GASB Statement No. 51

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* (GASB No. 51). This statement establishes accounting and financial reporting standards for intangible assets. Intangible assets include, but are not limited to, easements, water rights, timber rights, patents, trademarks, and computer software. This statement is effective for the Department beginning fiscal year 2010. The Department has not yet determined the financial statement impact of adopting this new statement.

(e) GASB Statement No. 53

In June 2008, the GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB No. 53). This statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. Common types of derivative instruments used by the Department include electricity swaps, forward contracts, and financial natural gas hedges. Governments enter into derivative instruments as investments; as hedges of identified financial risks associated with assets or liabilities, or expected transactions (i.e., hedgeable items); or to lower cost of borrowings. Governments often enter into derivative instruments with the intention of effectively fixing cash flows or synthetically fixing prices. The changes in fair value of derivative instruments that are used for investment purposes or that are reported as investment derivative instruments because of ineffectiveness are reported within the investment revenue classification. Alternatively, the changes in fair value of derivative instruments that are classified as hedging derivative instruments are reported in the statements of net assets or deferrals on the balance sheets. This statement is effective for the

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Department beginning fiscal year 2010. The Power System has not yet determined the financial statement impact of adopting this new statement.

(3) Regulatory Matters

(a) *Federal Regulation of Transmission Access*

The Energy Policy Act of 1992 (the Energy Policy Act) made fundamental changes in the federal regulation of the electric utility industry, particularly in the area of transmission. As amended by the Energy Policy Act, Sections 211, 212, and 213 of the Federal Power Act (FPA) provide Federal Energy Regulatory Commission (FERC) authority, upon application by any electric utility, federal power marketing agency, or other person or entity generating electric energy for sale or resale, to require a transmitting utility to provide transmission services (including any enlargement of transmission capacity necessary to provide such services) to the applicant at rates, charges, terms, and conditions set by FERC based on standards and provisions in the FPA. Under the Energy Policy Act, electric utilities owned by municipalities and other public agencies, which own or operate electric power transmission facilities that are used for the sale of electric energy at wholesale rates are “transmitting utilities” subject to the requirements of Sections 211, 212, and 213.

FERC has encouraged in the past the voluntary formation of regional transmission organizations (RTOs) independent from owners of generation and other market participants that will provide transmission access on a nondiscriminatory basis to buyers and sellers of power. Investor-owned utilities (IOUs) and publicly owned utilities have been encouraged to participate in the formation and operation of RTOs, but are not, at this time, being ordered by FERC to participate. FERC has adopted a “go slow” approach to the issue of RTO formation in the western United States; it is contemporaneously engaged in a wholesale overhaul of the California market design, referred to initially as the Market Design 2002 proceeding and lately as the Market Redesign and Technology Update (MRTU) proceeding. These FERC proceedings will have potential impacts on every electric utility doing business in California. MRTU involves a comprehensive overhaul of the electricity markets administered by California Independent System Operator (CAISO), including the areas of transmission congestion management, trading and scheduling energy in the day ahead, or spot market, improved market power mitigation, and pricing transparency measures and system improvements to increase operational efficiency and enhance reliability, among other things. MRTU was implemented on April 1, 2009. It is not certain at this time what impact, if any, FERC’s final decision on MRTU will have on the Power System. In addition, CAISO has announced its intention to implement further market changes over the next five years.

(b) *Federal Energy Legislation of 2005*

On August 8, 2005, the Energy Policy Act of 2005 (the EP Act) was enacted, the first comprehensive energy legislation in over a decade. One of the most significant provisions of the EP Act empowers FERC to certify an Electric Reliability Organization (ERO) to improve the reliability of the nation’s “bulk-power system” through mandatory and enforceable electric reliability standards (in contrast to the long-standing voluntary system). The definition of “bulk-power system” does not include facilities used in the local distribution of electric energy. The ERO will file any proposed reliability standard or modification with FERC. A “reliability standard” is a requirement that provides for

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reliable operation of the bulk-power system. Such a standard includes requirements for the operation of existing transmission facilities or the design of planned additions or modifications to the extent necessary to provide for reliable operation. It does not include, and the ERO may not impose, any requirement to enlarge existing facilities or to construct new transmission or generation. All users, owners, and operators of the bulk-power system are required to comply with the electric reliability standards. The ERO may impose a penalty on a user, owner, or operator for violating a reliability standard, and FERC may order compliance with such a standard and impose a penalty if it finds that a user, owner, or operator is about to engage in an act that would violate a reliability standard.

The EP Act authorizes FERC to require nondiscriminatory access to transmission facilities owned by municipal, cooperative, and other transmission companies not currently regulated by FERC, unless exercising this authority would violate a private activity bond rule for purposes of Section 141 of the Internal Revenue Code of 1986. FERC is prohibited from requiring any such entities to join RTOs. The EP Act also allows FERC to issue permits for the construction of new transmission facilities when states have been unable or unwilling to act and allows load-serving entities to use the firm transmission rights, or equivalent tradable or financial transmission rights, in order to deliver output or purchased energy to the extent required to meet its service obligations. The EP Act does not relieve a load-serving entity from any obligation under state or local law to build transmission or distribution facilities adequate to meet its service obligations, or to abrogate preexisting firm transmission service contracts.

The EP Act directs FERC to establish, by rule, incentive-based rates for transmission no later than August 2006 and requires FERC to establish market transparency rules for the electric wholesale market (entities that have a de minimis market presence are exempt from the rules). The EP Act instructs that the market transparency rules must provide for the timely dissemination of information about the availability and prices of wholesale electric energy and transmission service to FERC, state commission, buyers and sellers of wholesale electric energy, users of transmission services, and the public. Within 180 days of the EP Act's enactment, FERC and the Commodity Futures Trading Commission are required to enter into a memorandum of understanding regarding information sharing pursuant to these rules.

In addition, the EP Act prohibits any person from willfully and knowingly reporting false information to any federal agency on the price of wholesale electricity or availability of transmission capacity, or using (directly or indirectly) any manipulative device in contravention of any FERC rule. The EP Act increases civil and criminal penalties, modifies the procedures for review of FERC orders under the FPA, and changes the refund date under the FPA to be effective as of the date an applicable complaint is filed. The EP Act also establishes an entity's right to a refund if (i) it makes a short term sale of electric energy through an organized market in which the rates for the sale are set by a FERC-approved tariff (not by a contract) and (ii) the sale violates the terms of the tariff or applicable FERC rule in effect at the time of the sale.

Based on the EP Act authority vested upon the FERC, the FERC approved the North American Electric Reliability Corporation (NERC) as the ERO, and last year made mandatory more than 80 NERC and Western Electricity Coordinating Council (WECC) reliability standards, all of which are subject to penalties ranging from \$1,000 to \$1,000,000, depending on the impact of the violation

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to reliability and other factors. LADWP has implemented a NERC/WECC Reliability Standards Compliance Program to proactively prevent, monitor, and stop any potential violations to these standards.

The overall impact of the EP Act on the Department cannot be predicted at this time.

(c) *Potential Federal Energy Legislation for 2009*

As of August 2009, the 111th United States Congress is contemplating passing federal legislation that can make fundamental changes in the regulation of the electric utility industry. Under the House of Representatives' passed legislation (H.R. 2454 American Clean Energy and Security Act of 2009 – ACES), the following economy-wide reduction goals of GHGs (carbon dioxide, methane, nitrous oxide, sulfur hexafluoride, hydrofluorocarbons, perfluorocarbons, and nitrogen hexafluoride) are being proposed: 97% of the 2005 levels by 2012; 80% of the 2005 levels by 2020; 58% of the 2005 levels by 2038; 17% of the 2005 levels by 2050. The bill would delegate authority to FERC to promulgate regulations and enforce the reduction goals.

ACES includes a GHG “Cap and Trade” regulatory program. Under the Cap and Trade program, the amount of GHGs emitted by certain industries will be limited, and emission allowances will be available for trading (one allowance is equal to 1 metric ton of GHGs emitted, measured in tons of carbon dioxide equivalent). The proposal establishes a prohibition of emissions beyond an entity's allowance holdings where penalties will be applied to noncomplying entities. The electricity sector is covered under this provision starting 2012. Approximately 44.6% of allowances are allocated to the electricity sector starting 2012, and any additional allowances needed may be bought in the market or through the auction process. The total amount of allowances allocated decline each year, and are phased out by 2030. At that time, the electricity sector would need to purchase allowances to cover its GHG emissions. ACES delegates authority to FERC to provide oversight and regulation of the new Energy Markets created for carbon allowances and offsets. FERC is expected to ensure market transparency and liquidity of allowances and offsets. It will also be in charge of protecting market participants from speculation and manipulation of carbon prices.

On September 30, 2009, the Senate introduced its climate change bill entitled “Clean Energy Jobs and American Power Act” (S. 1733). The Senate Environment and Public Works Committee has held a number of hearings with panels on jobs and opportunities, national security, utilities, adaptation, transportation and the clean energy economy.

In the Senate version of the bill (S. 1462 Energy Bill – Senate Bill), FERC is given the authority to order a change or suspension of any rate, term, or condition if a market emergency occurs, such as market manipulation or abuse, and may require an entity to cease and desist from committing such violations.

ACES requires retail electric suppliers to meet a certain percentage of their load with electricity generated from renewable sources and savings. The percentages currently proposed are: 6% of electricity generated from renewables and electricity savings by 2012, and 20% by 2020. This legislation also authorizes FERC (upon petition of the governor of any state) to increase the

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proportion of compliance that can be met with efficiency savings up to 2/5 for electric suppliers located within that state.

With respect to transmission issues, the Senate Bill addresses planning, siting, and cost allocation. FERC is to publish rules establishing planning principles for the development of interconnection-wide plans, which identify high-priority national transmission projects, and to lead coordination of such plans. FERC will have the authority to approve the construction of high-priority national transmission projects that it finds to be in the public interest, if the state rejects the application of the project. Furthermore, FERC is to establish rules governing cost allocation methodologies for high-priority transmission projects, and may allocate costs to Load Servicing Entities within all, or part of a region. The costs may not be allocated unless they are reasonably proportional to measurable economic and regional benefits. Also, costs may be allocated to generators of electricity connected by a high-priority national transmission project.

Cyber assets security is also being addressed in the Senate Bill. If the Secretary of Energy determines that immediate action is necessary to protect critical electric infrastructure from a cyber security threat, the secretary may require, by order, with or without notice, people subject to the jurisdiction of FERC to take actions that the Secretary of Energy determines will best avert or mitigate the cyber security threat.

The overall impact of the proposed legislation on the Department cannot be predicted at this time.

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(4) Utility Plant

The Power System had the following activities in utility plant during fiscal year 2009 (amounts in thousands):

	<u>Balance, July 1, 2008</u>	<u>Additions</u>	<u>Retirements and disposals</u>	<u>Transfers</u>	<u>Balance, June 30, 2009</u>
Nondepreciable utility plant:					
Land and land rights	\$ 155,707	21	(349)	—	155,379
Construction work in progress	889,226	371,182	—	(651,293)	609,115
Nuclear fuel	32,982	10,639	(6,717)	—	36,904
Natural gas field	228,824	1,614	(6,821)	—	223,617
Total nondepreciable utility plant	<u>1,306,739</u>	<u>383,456</u>	<u>(13,887)</u>	<u>(651,293)</u>	<u>1,025,015</u>
Depreciable utility plant:					
Generation	3,487,385	7,541	(2,019)	415,861	3,908,768
Transmission	797,845	5,829	(2,205)	71,556	873,025
Distribution	4,711,830	236,305	(2,222)	157,303	5,103,216
General	1,027,269	73,230	(291)	6,573	1,106,781
Total depreciable utility plant	<u>10,024,329</u>	<u>322,905</u>	<u>(6,737)</u>	<u>651,293</u>	<u>10,991,790</u>
Accumulated depreciation:					
Generation	(2,133,877)	(112,790)	2,019	—	(2,244,648)
Transmission	(298,689)	(16,100)	2,205	—	(312,584)
Distribution	(2,014,129)	(133,759)	2,222	—	(2,145,666)
General	(672,543)	(25,013)	291	—	(697,265)
Total accumulated depreciation	<u>(5,119,238)</u>	<u>(287,662)</u>	<u>6,737</u>	<u>—</u>	<u>(5,400,163)</u>
Total utility plant, net	<u>\$ 6,211,830</u>	<u>418,699</u>	<u>(13,887)</u>	<u>—</u>	<u>6,616,642</u>

Depreciation and amortization expense during fiscal year 2009 was \$293.2 million.

Land and land rights are recorded on the balance sheet as utility plant in their functional category.

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The Power System had the following activities in utility plant during fiscal year 2008 (amounts in thousands):

	<u>Balance, July 1, 2007</u>	<u>Additions</u>	<u>Retirements and disposals</u>	<u>Transfers</u>	<u>Balance, June 30, 2008</u>
Nondepreciable utility plant:					
Land and land rights	\$ 143,513	12,194	—	—	155,707
Construction work in progress	773,694	306,635	—	(191,103)	889,226
Nuclear fuel	18,311	20,340	(5,669)	—	32,982
Natural gas field	235,163	1,071	(7,410)	—	228,824
	<u>1,170,681</u>	<u>340,240</u>	<u>(13,079)</u>	<u>(191,103)</u>	<u>1,306,739</u>
Total nondepreciable utility plant					
Depreciable utility plant:					
Generation	3,465,219	40,280	(29,727)	11,613	3,487,385
Transmission	882,586	6,000	(97,451)	6,710	797,845
Distribution	4,400,292	155,380	(1,587)	157,745	4,711,830
General	974,186	40,872	(2,824)	15,035	1,027,269
	<u>9,722,283</u>	<u>242,532</u>	<u>(131,589)</u>	<u>191,103</u>	<u>10,024,329</u>
Total depreciable utility plant					
Accumulated depreciation:					
Generation	(2,049,213)	(114,391)	29,727	—	(2,133,877)
Transmission	(376,658)	(19,482)	97,451	—	(298,689)
Distribution	(1,893,791)	(121,925)	1,587	—	(2,014,129)
General	(650,214)	(25,153)	2,824	—	(672,543)
	<u>(4,969,876)</u>	<u>(280,951)</u>	<u>131,589</u>	<u>—</u>	<u>(5,119,238)</u>
Total accumulated depreciation					
Total utility plant, net	\$ <u>5,923,088</u>	<u>301,821</u>	<u>(13,079)</u>	<u>—</u>	<u>6,211,830</u>

Depreciation and amortization expense during fiscal year 2008 was \$281.5 million.

Land and land rights are recorded on the balance sheet as utility plant in their functional category.

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(5) Jointly Owned Utility Plant

The Power System has direct interests in several electricity generating stations and transmission systems, which are jointly owned with other utilities. As of June 30, 2009 and 2008, utility plant includes the following amounts related to the Power System's ownership interest in each jointly owned utility plant (amounts in thousands, except as indicated):

	Ownership interest	Share of capacity (MWs)	Utility plant in service June 30, 2009		Utility plant in service June 30, 2008	
			Cost	Accumulated depreciation	Cost	Accumulated depreciation
Palo Verde Nuclear Generating Station	5.7%	224	\$ 564,654	332,324	567,538	318,491
Navajo Generating Station	21.2	477	316,560	284,486	315,978	269,955
Mohave Generating Station	10.0	—	57,913	57,852	57,913	56,851
Pacific Intertie DC Transmission Line	40.0	1,240	170,808	44,599	161,623	40,678
Other transmission systems	—	Various	84,779	44,652	81,167	43,544
			<u>\$ 1,194,714</u>	<u>763,913</u>	<u>1,184,219</u>	<u>729,519</u>

The Power System will incur operating costs related to the jointly owned facilities, regardless of the amount or its ability to take delivery of its share of energy generated. The Power System's proportionate share of the operating costs of the joint plants is included in the corresponding categories of operating expenses.

(6) Purchase Power Commitments

As of June 30, 2009, the Power System has entered into a number of energy and transmission service contracts, which involve substantial commitments as follows (amounts in thousands, except as indicated):

	Agency	Agency share	The Power System's interest in agency's share		
			Interest	Capacity (MWs)	Outstanding principal
Intermountain Power Project	IPA	100.0%	57.1%	1,027	\$ 1,087,209
Palo Verde Nuclear Generating Station	SCPPA	5.9	67.0	151	66,886
Mead-Adelanto Project	SCPPA	68.0	36.0	291	71,383
Mead-Phoenix Project	SCPPA	17.8 – 22.4	25.0	148	15,793
Southern Transmission System	SCPPA	100.0	60.0	1,142	554,434

IPA – The Intermountain Power Agency (IPA) is an agency of the state of Utah established to own, acquire, construct, operate, maintain, and repair the Intermountain Power Project (IPP). The Power System serves as the project manager and operating agent of IPP.

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

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The above agreements require the Power System to make certain minimum payments, which are based primarily upon debt service requirements. In addition to average annual fixed charges of approximately \$285 million during each of the next five years, the Power System is required to pay for operating and maintenance costs related to actual deliveries of energy under these agreements (averaging approximately \$384 million annually during each of the next five years). The Power System made total payments under these agreements of approximately \$496 million and \$490 million in fiscal years 2009 and 2008, respectively. These agreements are scheduled to expire from 2027 to 2030.

The Power System earned fees under the IPP project manager and operating agent agreements totaling \$18.4 million and \$16.0 million in fiscal years 2009 and 2008, respectively.

(a) Long-Term Notes Receivable

Under the terms of its purchase power agreement with IPA, the Department is charged for its output entitlements based on its share of IPA's costs, including debt service. During fiscal year 2000, the Department restructured a portion of this obligation by transferring \$1.11 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 7 and 10). IPA used the proceeds from these transactions to defease and to tender bonds with par values of approximately \$618 million and \$611 million, respectively.

On September 7, 2000, the Department paid \$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.

On July 20, 2005, the Department paid \$97 million to IPA in exchange for additional long-term notes receivable. IPA used the proceeds to defease bonds with a face value of \$92 million.

The IPA notes are subordinate to all of IPA's publicly held debt obligations. The Power System's future payments to IPA will be partially offset by interest payments and principal maturities from the subordinated notes receivable. The net IPA notes receivable balance totaled \$1.11 billion and \$1.12 billion as of June 30, 2009 and 2008, respectively.

The IPA notes pay interest and principal monthly and mature on July 1, 2023. The interest rates range from 4.9% to 6.4%, subject to adjustments related to IPA bond refundings.

(b) 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 Power System's share of capacity at Hoover is approximately 500 MWs (maximum capability). The cost of power purchased under this contract was \$16 million and \$15 million as of June 30, 2009 and 2008, respectively.

The Department has a contract through 2026 with SCPPA for the purchase of available energy generated at the Pebble Springs Wind Project located in Gilliam County, Oregon. The Power System's share of capacity at Pebble Springs is approximately 69 MWs (maximum capacity). The cost of power purchased under this contract was \$5 million as of June 30, 2009.

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(7) Cash, Cash Equivalents, and Investments

(a) Restricted and Other Investments

A summary of the Power System's restricted and other investments is as follows (amounts in thousands):

	June 30	
	2009	2008
Restricted and other investments:		
Restricted investments:		
Debt Reduction Trust Funds	\$ 547,282	528,988
Nuclear Decommissioning Trust Funds	113,923	110,234
Natural Gas Trust Fund	25,040	25,133
Power Rate Stabilization Fund	—	24,397
Hazardous Waste Treatment Trust Fund	2,122	—
SCPPA Palo Verde investment	33,707	34,594
Total restricted investments	722,074	723,346
Other investments:		
Cash collateral received from securities lending transactions – Department program only* (see note 8)	8,591	115,409
Total restricted and other investments	\$ 730,665	838,755

* The Power System also has \$0 and \$124,294 of cash collateral received from securities lending transactions in the City's securities lending program as of June 30, 2009 and 2008, respectively (see notes 7(b) and 8).

All restricted and other investments are to be used for a specific purpose as follows:

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 IPP and SCPPA (see note 6). The Department has transferred funds from purchased power precollections into these trust funds. Funds from operations may also 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 PVNGS at the end of its useful life (see note 1).

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Natural Gas Trust Fund

The natural gas trust fund was established to serve as depository to pay for costs and to post margin or collateral in connection with contracts for the purchase and delivery of financial transactions for natural gas. These transactions are entered into to stabilize the natural gas portion of the Department's fuel for generation costs.

Power Rate Stabilization Fund

The power rate stabilization fund was established in accordance with the general provisions section of the Department's electric rates to offset any unexpected revenue losses. The fund was closed in June 2009.

Hazardous Waste Treatment Storage and Disposal Trust Fund

The hazardous waste treatment storage and disposal trust fund was established to provide financial assurance for closure of the Main Street treatment and disposal facility.

SCPPA Palo Verde Investment

The SCPPA Palo Verde investment is a fixed rate investment held by SCPPA to be drawn down over the next 8 years to pay for purchased power obligations arising from the Department's participation in the SCPPA Palo Verde project. The fixed interest rate is 4.97% and the maturity date is June 25, 2017.

As of June 30, 2009, the Power System's securities lending cash collateral and restricted investments and their maturities are as follows (in thousands):

Type of investment	Fair value	Investment maturities				
		1 to 30 days	31 to 60 days	61 to 365 days	366 days to 5 years	Over 5 years
U.S. government agencies	\$ 475,702	—	1,216	98,743	311,674	64,069
Medium-term notes	59,867	2,889	8,333	34,818	13,827	—
Commercial paper	9,982	—	4,993	4,989	—	—
Certificates of deposit	11,018	—	—	11,018	—	—
California local agency bonds	9,981	8,945	—	1,036	—	—
California state bonds	5,680	5,680	—	—	—	—
Money market funds	116,138	116,138	—	—	—	—
Securities lending cash collateral:						
Money market funds	8,591	8,591	—	—	—	—
SCPPA Palo Verde investment	33,706	—	—	—	—	33,706
	<u>\$ 730,665</u>	<u>142,243</u>	<u>14,542</u>	<u>150,604</u>	<u>325,501</u>	<u>97,775</u>

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As of June 30, 2008, the Power System's securities lending cash collateral and restricted investments and their maturities are as follows (in thousands):

Type of investment	Fair value	Investment maturities				
		1 to 30 days	31 to 60 days	61 to 365 days	366 days to 5 years	Over 5 years
U.S. government agencies	\$ 407,472	7,496	7,477	58,518	277,162	56,819
Medium-term notes	176,767	4,999	32,551	80,379	58,838	—
Commercial paper	61,306	44,289	—	17,017	—	—
Certificates of deposit	39,208	11,200	1,000	27,008	—	—
Bankers acceptances	999	999	—	—	—	—
Money market funds	3,000	3,000	—	—	—	—
Securities lending cash collateral:						
Repurchase agreements	86,000	86,000	—	—	—	—
Commercial paper	15,936	15,936	—	—	—	—
Money market funds	13,473	13,473	—	—	—	—
SCPPA Palo Verde investment	34,594	—	—	—	—	34,594
	<u>\$ 838,755</u>	<u>187,392</u>	<u>41,028</u>	<u>182,922</u>	<u>336,000</u>	<u>91,413</u>

i. Interest Rate Risk

The Department's investment policy limits the maturity of its investments to a maximum of 30 years for U.S. government agency securities; 5 years for medium-term corporate notes, California local agency obligations, and California state obligations and municipal bonds; 270 days for commercial paper; 397 days for certificates of deposit; 180 days for bankers acceptances; and 45 days for repurchase agreements purchased with cash collateral from securities lending agreements.

ii. Credit Risk

Under its investment policy and the Code, the Department is subject to the prudent investor standard of care in managing all aspects of its portfolios. The prudent investor standard requires that the Department "...shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and in familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency."

The U.S. government agency securities in the portfolio consist of securities issued by government-sponsored enterprises, which are not explicitly guaranteed by the U.S. government. As of June 30, 2009 and 2008, the U.S. government agency securities in the portfolio carried the highest possible credit ratings by the Nationally Recognized Statistical Rating Organizations (NRSROs) that rated them.

The Department's investment policy specifies that medium-term corporate notes must be rated in a rating category of "A" or its equivalent or better by a NRSRO. Of the Power System's

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investments in corporate notes as of June 30, 2009, \$33,861,542 (57%) was rated in the category of AA and \$25,737,850 (43%) was rated in the category of A by at least one NRSRO. The remaining \$267,713 (less than 1%) of investments in corporate notes were not rated. Of the Power System's investments in corporate notes as of June 30, 2008, \$25,241,490 (15%) was rated in the category of AAA, \$70,577,369 (38%) was rated in the category of AA, and \$80,947,666 (47%) was rated in the category of A by at least one NRSRO.

The Department's investment policy specifies that commercial paper must be of the highest ranking or of the highest letter and number rating as provided for by at least two NRSROs. As of June 30, 2009 and 2008, all of the Power System's investments in commercial paper were rated with at least the highest letter and number rating as provided by at least two NRSROs.

The Department's investment policy specifies that negotiable certificates of deposit must be of the highest ranking or letter and number rating as provided for by at least two NRSROs and that for nonnegotiable certificates of deposit, the full amount of principal and interest is insured by the Federal Deposit Insurance Corporation (FDIC) or National Credit Union Administration. As of June 30, 2009, the Power System's investments in certificates of deposits included \$10,018,030 of negotiable certificates of deposit of the highest ranking as provided by at least two NRSROs and \$1,000,000 of nonnegotiable certificates of deposit fully insured by the FDIC. As of June 30, 2008, the Power System's investments in certificates of deposit were all negotiable certificates of deposits rated with at least the highest letter and number rating as provided for by at least two NRSROs.

The Department's investment policy specifies that California local agency obligations must be rated in a rating category of "A" or its equivalent or better by a NRSRO. Of the Power System's investments in California local agency bonds as of June 30, 2009, \$8,945,000 (90%) was rated in the category of AAA and \$1,035,850 (10%) was rated in the category of AA by at least one NRSRO.

The Department's investment policy does not establish a minimum credit rating for state of California obligations. As of June 30, 2009, the Power System's investments in State of California obligations were rated AAA by at least one NRSRO.

The Department's investment policy specifies that banker's acceptances must be of the highest ranking or letter and number rating as provided for by at least two NRSROs. As of June 30, 2008, all of the Power System's investments in banker's acceptances were rated with the highest rating as provided by three NRSROs.

The Department's investment policy specifies that money market funds may be purchased as allowed under the Code, which requires that the fund must have either 1) attained the highest ranking or highest letter and numerical rating provided by not less than two NRSROs or 2) retained an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience in managing money market mutual funds with assets under management in excess of \$500 million. As of June 30, 2009 and 2008, each of the money market funds in the portfolio had the highest possible

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ratings by three NRSROs, specifically AAAm by Standard and Poor's Corporation (S&P), Aaa by Moody's Investors Service (Moody's), and AAA by Fitch Ratings (Fitch).

The Department's securities lending cash collateral investment policy specifies that repurchase agreement transactions shall be limited to broker/dealers or banks for which a securities lending line has been approved by the securities lending agent. Approved counterparties must be primary dealers in U.S. government securities that work directly with the Federal Reserve Bank of New York. Repurchase agreements must be adequately collateralized based on the margin requirements for the type of security listed in the investment policy. As of June 30, 2008, the counterparty to the repurchase agreement was an approved primary dealer rated with the highest short-term ratings as provided by two NRSROs. The collateral for the repurchase agreement consisted of mortgage-backed securities issued by U.S. government agencies that had minimum credit ratings of AAA with a margin of 102% of the repurchase agreements.

The Department's securities lending cash collateral investment policy specifies that commercial paper must be of the highest ranking or of the highest letter and number rating as provided for by at least two NRSROs. As of June 30, 2008, all of the commercial paper purchased with cash collateral had the highest letter and number rating provided by two NRSROs.

The Department's securities lending cash collateral investment policy specifies that money market funds may be purchased with cash collateral as allowed under the Code. As of June 30, 2009 and 2008, the money market funds purchased with cash collateral were in compliance with the Code by having either attained the highest possible ratings by at least two NRSROs or retained an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience in managing money market mutual funds with assets under management in excess of \$500 million.

iii. Concentration of Credit Risk

The Department's investment policy specifies that there is no percentage limitation on the amount that can be invested in U.S. government agency securities, except that a maximum of 30% of the cost value of the portfolio may be invested in the securities of any single U.S. government agency issuer.

Of the Power System's total investments as of June 30, 2009, \$159,456,292 (22%) was invested in securities issued by the Federal Home Loan Bank; \$154,727,884 (21%) was invested in securities issued by the Federal Home Loan Mortgage Corporation; and \$140,307,268 (19%) was invested in securities issued by the Federal National Mortgage Association.

Of the Power System's total investments as of June 30, 2008, \$145,877,625 (17%) was invested in securities issued by the Federal Home Loan Mortgage Corporation; \$128,932,312 (15%) was invested in securities issued by the Federal Home Loan Bank; and \$103,799,161 (12%) was invested in securities issued by the Federal National Mortgage Association.

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For overnight or open repurchase agreements, the Department's securities lending policy does not limit the percentage of cash collateral that may be invested with one particular counterparty.

Of the Power System's total investments as of June 30, 2008, cash collateral received from securities lending transactions of \$85,000,000 (10%) was invested in an overnight repurchase agreement with Morgan Stanley. In addition, \$4,980,630 (1%) was invested in a medium-term corporate note issued by Morgan Stanley, for a total of \$89,980,630 (11%) invested in securities issued by Morgan Stanley.

(b) Pooled Investments

The Power System's cash, cash equivalents, and its collateral value of the City's securities lending program are included within the City Treasury's general and special investment pool (the Pool). As of June 30, 2009 and 2008, the Power System's share of the Pool was \$854,539,000 and \$1,008,335,000, which represents approximately 15% and 14% of the Pool, respectively.

At June 30, 2009, the investments held in the Pool's programs and their maturities are as follows (amounts in thousands):

Type of investments	Amount	Investment maturities			
		1 to 30 days	31 to 60 days	61 to 365 days	366 days to 5 years
U.S. Treasury notes	\$ 1,613,049	—	—	—	1,613,049
U.S. Treasury bills	44,984	—	44,984	—	—
U.S. sponsored agency issues	1,428,909	164,842	82,201	182,052	999,814
Medium term notes	1,047,781	—	25,153	125,866	896,762
Commercial paper	1,348,312	992,287	235,582	120,443	—
Guaranteed investment contracts	70,081	70,081	—	—	—
Certificates of deposit	9,000	—	—	9,000	—
Short term investment funds	3	3	—	—	—
Total general and special pools	\$ 5,562,119	1,227,213	387,920	437,361	3,509,625

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At June 30, 2008, the investments held in the Pool's programs and their maturities are as follows (amounts in thousands):

Type of investment	Amount	Investment maturities			
		1 to 30 days	31 to 60 days	61 to 365 days	366 days to 5 years
U.S. Treasury notes	\$ 1,619,055	—	—	—	1,619,055
U.S. government agencies	1,530,897	230,356	174,594	224,569	901,378
Medium-term notes	1,186,097	—	—	352,990	833,107
Commercial paper	1,984,742	1,450,906	386,282	147,554	—
Guaranteed investment contract	135,224	135,224	—	—	—
Certificates of deposit	8,000	—	—	8,000	—
State of California LAIF	1	1	—	—	—
Short-term investment funds	38	38	—	—	—
Securities lending cash collateral:					
U.S. Treasury notes	918,758	—	—	—	918,758
U.S. government agencies	10,721	—	—	—	10,721
Total general and special pools	\$ 7,393,533	1,816,525	560,876	733,113	4,283,019

Interest Rate Risk. The City's pooled investment policy limits the maturity of its investments to a maximum of five years for U.S. Treasury and federal agency securities, medium term corporate notes, and bonds issued by local agencies; 270 days for commercial paper, and 32 days for repurchase agreements.

Credit Risk. The City's pooled investment policy requires that for all classes of investments, except linked banking program certificates of deposits, the issuers' minimum credit ratings shall be Standard and Poor's Corporation (S&P) A-1/A or Moody's Investor Services (Moody's) P-1/A2 and, if available, Fitch IBCA F1/A. In addition, domestic banks are limited to those with a current Fitch Ratings BankWatch of "B/C" or better and an A-1 short-term rating. The City Treasurer is granted the authority to specify approved California banks with a Fitch Ratings BankWatch of "C" or better and an A-2 rating where appropriate. In addition to a "AAA" rating for country risk, foreign banks with domestic licensed offices must be rated "B" or better and TBW-1 short-term rating by Fitch Ratings BankWatch. Domestic savings banks must be rated "B/C" or better and a TBW-1 short-term rating by Fitch Ratings BankWatch.

Medium term notes must be issued by corporations operating within the United States and having total assets in excess of \$500 million. Commercial paper issuers must meet the preceding requirement or must be issued by corporations organized in the United States as a special purpose corporation, trust or limited liability company having program-wide credit enhancements.

At June 30, 2009, the City's \$1.43 billion investments in U.S. government sponsored enterprises consist of securities issued by the Federal Home Loan Bank – \$472.7 million, Federal National Mortgage Association – \$272.4 million, Federal Home Loan Mortgage Corporation – \$398.9 million, Federal Farm Credit Bank – \$126.0 million, Tennessee Valley Authority –

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\$37.1 million, Freddie Mac Discount Note – \$69.3 million, and Farmer Mac Federal Agricultural – \$52.6 million. As of June 30, 2009, these securities carried the highest ratings of AAA (S&P) and Aaa (Moody's).

The City's \$1.05 billion investments in medium-term notes consist of securities issued by banks and corporations that comply with the requirements discussed above and were rated "A" or better by S&P and "A3" or better by Moody's.

The City's \$1.35 billion investments in commercial paper comply with the requirements discussed above and were rated A-1+/A-1 by S&P and P-1 by Moody's.

The issuers of the certificates of deposits are not rated.

At June 30, 2008 the City's \$1.53 billion investments in U.S. government-sponsored enterprises consist of securities issued by the Federal Home Loan Bank – \$594.5 million, Federal National Mortgage Association – \$293.8 million, Federal Home Loan Mortgage Corporation – \$537.2 million, and Federal Farm Credit Bank – \$105.5 million. As of June 30, 2008, these securities carried the highest ratings of AAA (S&P) and Aaa (Moody's).

The City's \$1.19 billion investments in medium-term notes consist of securities issued by banks and corporations that comply with the requirements discussed above and were rated "A" or better by S&P and "A3" or better by Moody's.

The City's \$1.98 billion investments in commercial paper comply with the requirements discussed above and were rated AAA/A-1/A-1+ by S&P and Aaa/P-1 by Moody's.

The issuers of the guaranteed investment contracts, certificates of deposits, and the State of California Local Agency Investment Fund (LAIF) are not rated.

Concentration of Credit Risk. The City's investment policy does not allow more than 10% of its investments portfolio, except U.S. Treasury and U.S. sponsored agency issues, to be invested in securities of a single issuer including its related entities. The City's investment policy further provides for a maximum concentration limit of 30% on any individual federal agency or government-sponsored entity. The City's pooled investments comply with these requirements. GAAP requires disclosure of certain investments in any one issuer that represent 5% or more of total investments. Of the City's total pooled investments as of June 30, 2009, \$472.7 million (9%) was invested in securities issued by the Federal Home Loan Bank, \$398.9 million (7%) was invested in securities issued by Federal Home Loan Mortgage Corporation, and \$272.4 million (5%) was invested in securities issued by Federal National Mortgage Association. Of the City's total pooled investments as of June 30, 2008, \$594.5 million (8%) was invested in securities issued by the Federal Home Loan Bank and \$537.2 million (7%) was invested in securities issued by Federal Home Loan Mortgage Corporation.

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(8) Securities Lending Transactions

The Power System participates in a securities lending program as follows (collateral amounts in thousands):

Program	June 30	
	2009	2008
Department Program	\$ 8,591	115,409
City of Los Angeles Program	—	124,294
	<u>\$ 8,591</u>	<u>239,703</u>

(a) Department Program

In December 1999, the Department initiated a securities lending program managed by its custodial bank to increase interest income. The bank lends up to 20% of the investments held in the debt reduction trust funds, decommissioning trust funds, postemployment healthcare benefits trust 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 securities received as collateral only in the event of borrower default. Both the investments purchased with the cash collateral received and the related liability to repay the cash collateral are reported on the balance sheets. A summary of the Power System's portion of the Department's securities lending program as of June 30, 2009 and 2008 is as follows (amounts in thousands):

	June 30			
	2009		2008	
	Fair value of underlying securities	Collateral book value	Fair value of underlying securities	Collateral book value
Securities lent for cash collateral				
U.S. government and agency securities	\$ 8,387	8,591	113,063	115,409

Cash collateral received is reinvested by the lending agent in open repurchase agreements, money market funds, and short-term commercial papers so that the maturities of reinvested cash collateral sufficiently match the maturities of the underlying securities lent. 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 fiscal years 2009 and 2008.

(b) General Investment Pool Program

The Power System 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. However, due to the extreme volatility in the financial markets over the past 12 months resulting from the

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global financial crisis, and counterparty risks, the City temporarily suspended its securities lending program in November 2008. The City, however, continues to monitor the financial markets and will re-enter the securities lending market when deemed appropriate. As of June 30, 2009 and 2008, the Power System's attributed share of cash collateral and the related obligation from the City's program were \$0 and \$124.3 million, respectively.

Securities lending is permitted and limited under provisions of the Code's Section 53601. The City Council approved the Securities Lending Program (the SLP) on October 22, 1991 under Council File No. 91-1860, which complies with the Code. The objectives of the SLP in priority order are: safety of loaned securities and prudent investment of cash collateral to enhance revenue from the investment program. The SLP is governed by a separate policy and guidelines, with oversight responsibility of the Investment Advisory Committee.

The City's custodial bank acts as the securities lending agent. In the event a counterparty defaults by reason of an act of insolvency, the bank shall take all actions that it deems necessary or appropriate to liquidate permitted investment and collateral in connection with such transaction and shall make a reasonable effort for two business days (Replacement Period) to apply the proceeds thereof to the purchase of securities identical to the loaned securities not returned. If during the Replacement Period the collateral liquidation proceeds are insufficient to replace any of the loaned securities not returned, the bank shall, subject to payment by the City of the amount of any losses on any permitted investments, pay such additional amounts as necessary to make such replacement.

Under the provisions of the SLP, and in accordance with the Code, no more than 20% of the market value of the General Investment Pool (the Pool) is available for lending. The City receives cash as collateral on loaned securities, which is reinvested in securities permitted under the policy. In accordance with the Code, the securities lending agent marks to market the value of both the collateral and the reinvestments daily. Except for open loans where either party can terminate a lending contract on demand, term loans have a maximum life of 90 days. Earnings from securities lending accrue to the Pool and are allocated on a pro rata basis to all Pool participants.

At June 30, 2009 and 2008, the assets and liabilities arising from the reinvested cash collateral were recognized in the respective participants' financial statements. During the fiscal year, collateralizations on all loaned securities were within the required 102% of market value. The City 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. There was no credit risk exposure to the City as of June 30, 2008 because the amounts owed to the borrowers exceeded the amounts borrowed. Loaned securities are held by the City's agents in the City's name and are not subject to custodial credit risk.

(9) Derivative Instruments

In accordance with GASB Technical Bulletin 2003-01, the Power System does not record its derivative instruments on the balance sheets, but instead discloses the derivatives in the notes to the financial statements and records the impact upon settlement of the derivatives. The Power System had three main types of derivative instruments as of June 30, 2009 and 2008: electricity swaps, forward contracts, and

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financial natural gas hedges. As of June 30, 2009 and 2008, the fair values of these outstanding derivative instruments were \$(168.9) million and \$213.4 million, respectively.

(a) Objective of Electricity Swap and Forward Transactions

In order to obtain the highest market value on energy that is sold into the wholesale market, the Department monitors the sales price of energy, which varies based on which hub the energy is to be delivered. There are three primary hubs within the Department's transmission region: Palo Verde, California Oregon Border, and Mead. The Department enters into various locational swap transactions with other electric utilities in order to effectively utilize its transmission capacity and to achieve the most economical exchange of energy purchased and sold.

The Department enters into forward contracts in order to meet the electricity requirements to serve its customers.

The Department does not enter into swap and forward transactions for trading purposes. The Department is exposed to risk of nonperformance if the counterparties default or if the swap agreements are terminated.

(b) Objective of Financial Natural Gas Hedges

The Department enters into natural gas hedging contracts in order to stabilize the cost of gas needed to produce electricity to serve its customers.

As of June 30, 2009, the Power System had the following derivatives, which were not recorded on its balance sheet (amounts in thousands):

Derivative description	Total contract quantities	Contract price range \$per unit	First effective date	Last termination date	Fair value	Cash paid at derivative inception
Electricity swaps:						
Purchases	902,598 MW	\$ 40.00 – 74.95	07/01/09	12/31/09	(10,736)	—
Sales	902,598 MW	24.50 – 48.70	07/01/09	12/31/09	1,106	—
Forward contracts:						
Electricity	1,778,934 MW	37.52 – 75.67	07/01/09	12/31/11	(42,668)	—
Natural gas	25,440,000 MMBtu	5.28 – 5.71	07/01/09	01/31/14	(3,981)	—
Financial natural gas:						
Hedges*	97,042,000 MMBtu	2.56 – 9.85	07/01/09	06/30/18	(112,586)	—

* Financial hedges were variable to fixed rate swaps that serve to lock in a fixed cost of natural gas.

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As of June 30, 2008, the Power System had the following derivatives, which were not recorded on its balance sheet (amounts in thousands):

Derivative description	Total contract quantities	Contract price range \$per unit	First effective date	Last termination date	Fair value	Cash paid at derivative inception
Electricity swaps:						
Purchases	309,120 MW	\$ 128.36	07/01/08	12/31/08	\$ 193	—
Sales	309,120 MW	130.71	07/01/08	12/31/08	529	—
Forward contracts:						
Electricity	2,041,968 MW	69.30 – 118.31	07/01/08	12/31/11	37,356	—
Natural gas	584,000 MMBtu	8.91 – 11.78	07/01/08	09/30/08	269	—
Financial natural gas:						
Hedges*	78,738,500 MMBtu	4.30 – 9.85	07/01/08	06/30/17	175,060	(81)

* Financial hedges were variable to fixed rate swaps that serve to lock in a fixed cost of natural gas.

(c) Fair Value

All fair values were estimated using forward market prices available from broker quotes and exchanges.

(d) Credit Risk

The Power System is exposed to credit risk related to nonperformance by its wholesale counterparties under the terms of contractual agreements. In order to limit the risk of counterparty default, the Department has implemented a Wholesale Marketing Counterparty Evaluation Policy, which was amended and renamed as Counterparty Evaluation Credit Policy (the Policy), and was approved by the Board on May 6, 2008. Under the new policy, the scope has been expanded beyond physical power to include transmission, physical natural gas, and financial natural gas. Also, the credit limit structure has been categorized into short-term and long-term structures where the short-term structure is applicable to transactions with terms of up to 18 months and the long-term structure to cover transactions beyond 18 months.

The Policy includes provisions to limit risk including: the assignment of internal credit ratings to all Department's counterparties based on counterparty and/or debt ratings; the use of expected default frequency equivalent credit rating for short-term transactions; the requirement for credit enhancements (including advance payments, 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.

As of June 30, 2009, the 11 financial natural gas hedge counterparties were rated by Moody's as follows: one at Aaa, two at Aa1, one at Aa2, two at Aa3, three at A1, and two at A2. The counterparties were rated by S&P as follows: two at AA, three at AA-, two at A+, and four at A. As of June 30, 2008, the 12 financial natural gas hedge counterparties were rated by Moody's as

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follows: three at Aaa, five at Aa1, two at Aa3, and two at A1. The counterparties were rated by S&P as follows: two at AA+, four at AA, three at AA-, one at A+, and two at A.

Based on the International Swap Dealers Association agreements, the Department obtains collateral to support derivatives subject to credit risk in the form of cash, negotiable debt instruments (other than interest-only and principal-only securities), or eligible letters of credit. Collateral posted by a counterparty is held by a custodian.

As discussed in note 14, during fiscal year 2001, the Power System experienced nonperformance and material counterparty default with the CAISO and the California Power Exchange (CPX). The Power System does not anticipate nonperformance by any other of its counterparties and has no reserves related to nonperformance at June 30, 2009 and 2008, respectively. Apart from the events discussed in note 14, the Power System did not experience any material counterparty default during fiscal year 2009 or 2008.

(e) Basis Risk

The Department mitigates basis risk through long-term physical transportation contracts.

(f) Termination Risk

The Power System or its counterparties may terminate the contractual agreements if the other party fails to perform under the terms of the contract. No termination events have occurred and there are no out-of-the-ordinary termination events contained in contractual documents.

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(10) Long-Term Debt

Long-term debt outstanding as of June 30, 2009 and 2008 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	
				2009	2008
Issue of 2001, Series A1	03/20/01	4.931%	2025	\$ 813,055	993,895
Issue of 2001, Series A2	11/06/01	5.109	2022	109,095	109,095
Issue of 2001, Series B	06/05/01	Variable	2035	580,800	580,800
Issue of 2001, Series C1	11/15/01	4.788	2017	3,040	3,117
Issue of 2002, Series A	08/22/02	Variable	2036	388,500	388,500
Issue of 2002, Series C2	11/22/02	4.375	2018	8,688	8,931
Issue of 2003, Series A1	07/31/03	3.409	2017	307,655	347,675
Issue of 2003, Series A2	08/19/03	4.662	2032	515,830	515,830
Issue of 2003, Series B	08/28/03	5.013	2036	196,495	200,000
Issue of 2004, Series C3	04/07/04	4.298	2020	9,905	10,038
Issue of 2005, Series A1	12/28/05	4.700	2041	601,895	616,895
Issue of 2005, Series A2	12/28/05	4.700	2031	315,195	315,195
Issue of 2006, Series C4	03/01/06	4.040	2017	7,973	8,056
Issue of 2007, Series A1	10/18/07	4.659	2040	337,630	337,630
Issue of 2007, Series A2	10/18/07	4.638	2033	191,125	191,125
Issue of 2007, Series B	10/18/07	Variable	2042	—	125,000
Issue of 2008, Series A1	11/25/08	5.583	2039	200,000	—
Issue of 2008, Series A1	11/25/08	5.039	2033	350,000	—
Issue of 2009, Series A	02/19/09	4.773	2040	123,120	—
Issue of 2009, Series B	06/02/09	4.563	2025	172,125	—
Total principal amount				5,232,126	4,751,782
Revenue certificates				200,000	200,000
Unamortized premiums, discounts, and debt-related costs (including net loss on refundings), net				27,609	25,401
Debt due within one year (including current portion of variable rate debt)				(217,882)	(175,455)
				<u>\$ 5,241,853</u>	<u>4,801,728</u>

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Revenue bonds generally are callable 10 years after issuance. The Department has agreed to certain covenants with respect to bonded indebtedness. Significant covenants include the requirement that the Power Systems' 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 collateralized by the future revenues of the Power System.

(a) Long-Term Debt Activity

The Power System had the following activity in long-term debt for the fiscal years ended June 30, 2009 and 2008 (amounts in thousands):

	Balance, July 1, 2008	Additions	Reductions	Balance June 30, 2009	Current portion
Long-term debt:					
Bonds	\$ 4,777,183	850,459	(367,907)	5,259,735	197,882
Revenue certificates	200,000	—	—	200,000	20,000
Total	<u>\$ 4,977,183</u>	<u>850,459</u>	<u>(367,907)</u>	<u>5,459,735</u>	<u>217,882</u>
	Balance, July 1, 2007	Additions	Reductions	Balance June 30, 2008	Current portion
Long-term debt:					
Bonds	\$ 4,141,883	678,946	(43,646)	4,777,183	155,455
Revenue certificates	200,000	—	—	200,000	20,000
Total	<u>\$ 4,341,883</u>	<u>678,946</u>	<u>(43,646)</u>	<u>4,977,183</u>	<u>175,455</u>

(b) New Issuances

Fiscal Year 2009

In November 2008, the Power System issued \$550 million of Power System Revenue Bonds, 2008 Series A. The net proceeds of \$540 million from the transaction, which included a net issue discount and underwriters' discount of \$10 million, were deposited into the construction fund to be used for capital improvements.

In February 2009, the Power System issued \$123.12 million of Power System Revenue Bonds, 2009 Series A. The net proceeds of \$125 million from the transaction, net of \$1.9 million issue premium and underwriters' discount, were used to redeem the \$125 million Power System Variable Rate Revenue Bonds, 2007 Series B. This transaction resulted in a \$157.6 million net present value savings and a net loss for accounting purposes of \$953 thousand which was deferred and is being amortized over the life of the new bonds.

In June 2009, the Power System issued \$172.125 million of Power System Revenue Bonds, 2009 Series B. The net proceeds of \$181 million from the transaction, net of \$8.7 million issue premium and underwriters' discount, were used to refund the Power System Revenue Bonds, 2001 Series A,

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Subseries A-1 maturing on July 1, 2024. This transaction resulted in a \$7.28 million net present value savings and a net loss for accounting purposes of \$3.2 million which was deferred and is being amortized over the life of the new bonds.

(c) Outstanding Debt Defeased

The Power System defeased certain revenue bonds in prior years by placing cash or the proceeds of new revenue bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Power System's financial statements.

At June 30, 2009, the following revenue bonds outstanding are considered defeased (amounts in thousands):

Bond issues	Principal outstanding
Second issue of 1993	\$ 8,340
Refunding issue of 1994	31,775
Issue of 1994	5,590
	<u>\$ 45,705</u>

(d) Variable Rate Bonds

As of June 30, 2009 and 2008, the Power System had \$969.3 million in variable rate bonds.

The variable rate bonds currently bear interest at weekly and daily rates ranging from 0.27% to 0.30% as of June 30, 2009 and 1.55% to 1.65% as of June 30, 2008. The Power System 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 Power System has entered into standby and line of credit agreements with a syndicate of commercial banks in an initial amount of \$580.8 million and \$388.5 million to provide liquidity for the variable rate bonds. The extended standby agreements expire in January 2010 for the \$580.8 million issue and in June 2010 for the \$388.5 million issue.

The bonds that would be issued under the agreements will bear interest that is payable quarterly at the greater of the Federal Funds Rate plus 0.50% or the bank's announced base rate, as defined. The unpaid principal of bonds purchased is payable in 10 equal semiannual installments, commencing after the termination of the agreement. At its discretion, the Power System has the ability to convert the outstanding bonds to fixed rate obligations, which cannot be tendered by the bondholders.

The variable rate bonds have been classified as long term on the balance sheets as the liquidity facilities give the Power System the ability to refinance on a long term basis and the Power System intends to either renew the facility or exercise its right to tender the debt as a long term financing. The portion that would be due in the next fiscal year in the event that the outstanding variable rate bonds were tendered and purchased by the commercial banks under the standby agreements has been

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included in the current portion of long term debt and was \$96.9 million at both June 30, 2009 and 2008.

(e) Revenue Certificates

As of June 30, 2009 and 2008, the Power System has outstanding \$200 million of commercial paper bearing interest at an average rate of 0.33%. The commercial paper matures not more than 270 days from the date of issuance.

Effective September 6, 2007, the Department entered into a letter of credit and reimbursement agreement (the Agreement) with a commercial bank in the amount of \$200 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 after September 6, 2007. 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% of the banks announced base rate 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 September 5, 2010.

The revenue certificates have been classified as long term debt on the balance sheets as the Agreement gives the Power System the ability to refinance on a long term basis and the Power System intends to either renew the Agreement or exercise its option to draw on the Agreement. The portion that would be due in the next fiscal year in the event that the outstanding revenue certificates were advanced by the commercial bank under the Agreement has been included in the current portion of long term debt and was \$20 million at both June 30, 2009 and 2008.

(f) Scheduled Principal Maturities and Interest

Scheduled annual principal maturities and interest are as follows (amounts in thousands):

	<u>Principal</u>	<u>Interest and amortization</u>
Fiscal year(s) ending June 30:		
2010	\$ 100,952	236,569
2011	122,205	230,450
2012	135,794	224,291
2013	143,091	217,285
2014	146,990	209,978
2015 – 2019	756,884	938,755
2020 – 2024	846,670	739,009
2025 – 2029	988,890	519,979
2030 – 2034	1,155,040	290,997
2035 – 2039	764,680	76,622
2040 – 2044	70,930	938
	<u>5,232,126</u>	<u>3,684,873</u>
Total requirements	\$ 5,232,126	3,684,873

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The maturity schedule presented above reflects the scheduled debt service requirements for all of the Power System's long-term debt. The schedule is presented assuming that the tender options on the variable rate bonds, as discussed on the previous page, will not be exercised and that the full amount of the revenue certificates will be renewed. Should the bondholders exercise the tender options and the Power System convert all of the revenue certificates under the line of credit, the Power System would be required to redeem the \$1,169.3 million in variable rate bonds outstanding over the next six years, as follows: \$116.93 million in fiscal year 2010, \$233.86 million in each of the fiscal years 2011 through 2014, and \$116.93 million in fiscal year 2015. Accordingly, the balance sheets recognize the possibility of the exercise of the tender options and reflect the \$116.93 million that could be due in fiscal year 2010 as a current portion of long-term debt payable. Interest and amortization include interest requirements for variable rate bonds, using the variable debt interest rate in effect at June 30, 2009 of 0.15%.

(11) 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 defined 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 (ARC) as determined by the Plan's independent actuary. The required contributions are allocated between the Power System and the Water System 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. The Plan is an independent pension trust fund of the City.

Plan amendments must be approved by both the Retirement Board and the Board. The Plan issues separately available financial statements on an annual basis. Such financial statements can be obtained from the Department of Water and Power Retirement Office, 111 N. Hope, Room 357, Los Angeles, CA 90012.

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The annual pension cost (APC) and net pension asset for the Department's Plan consist of the following (amounts in thousands):

	Year ended June 30	
	2009	2008
Annual required contribution	\$ 143,698	144,744
Interest on net pension asset	(11,175)	(10,514)
Adjustment to annual required contribution	16,652	15,667
APC (including \$44.3 million and \$42.1 million of amounts capitalized in fiscal years 2009 and 2008, respectively)	149,175	149,897
Department contributions	(144,916)	(142,874)
Change in net pension asset	4,259	7,023
Net pension asset at beginning of year	(123,310)	(130,333)
Net pension asset at end of year	<u>\$ (119,051)</u>	<u>(123,310)</u>

The Power System's allocated share of the Plan's APC and net pension asset consists of the following (amounts in thousands):

	Year ended June 30	
	2009	2008
Annual required contribution	\$ 97,714	98,426
Interest on net pension asset	(7,599)	(7,149)
Adjustment to annual required contribution	11,324	10,653
APC (including \$26.6 million and \$25.0 million of amounts capitalized in fiscal years 2009 and 2008, respectively)	101,439	101,930
Power System contributions	(94,604)	(94,699)
Change in net pension asset	6,835	7,231
Net pension asset at beginning of year	(77,479)	(84,710)
Net pension asset at end of year	<u>\$ (70,644)</u>	<u>(77,479)</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 rolling 15-year periods effective July 1, 2000.

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

Fiscal year	Normal cost	Deficit amortization	Contribution rate
2009	12.68%	6.82	20.28%
2008	10.26	10.50	21.59

The significant actuarial assumptions include an investment rate of return of 8.00%, projected inflation adjusted salary increases of 4.25%, and cost-of-living increases of 3.75%. The actuarial value of assets is determined using techniques that smoothen the effects of short-term volatility in the market value of investments over a five-year period. Plan assets consist primarily of corporate and government bonds, common stocks, mortgage-backed securities, and short-term investments.

Trend information for fiscal years 2009, 2008, and 2007 for the Power System is as follows (amounts in thousands):

Year ended June 30	NPO asset	Percentage of APC contributed	APC
2009	\$ (70,644)	93%	\$ 101,439
2008	(77,479)	93	101,930
2007	(84,710)	85	100,156

(a) Disability and Death Benefits

The Power System's allocated share of disability and death benefit plan costs and administrative expenses totaled \$18 million and \$16 million for fiscal years 2009 and 2008, respectively.

(b) Funded Status and Funding Progress

As of July 1, 2008, the Department's actuarial value of assets was \$7.2 billion and Actuarial Accrued Liability (AAL) for benefits was \$7.6 billion, resulting in an Unfunded Actuarial Accrued Liability (UAAL) of \$371.2 million. The covered payroll (annual payroll of active employees covered by the Plan) was \$708.7 million, and the ratio of the UAAL to the covered payroll was 52%.

As of July 1, 2007, the Department's actuarial value of assets was \$6.9 billion, and Actuarial Accrued Liability (AAL) for benefits was \$7.5 billion, resulting in an Unfunded Actuarial Accrued Liability (UAAL) of \$603.0 million. The covered payroll (annual payroll of active employees covered by the Plan) was \$670.4 million, and the ratio of the UAAL to the covered payroll was 90%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the salary increases. Amounts determined regarding the funded status of the Plan and the annual required contributions of the Department are

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subject to continual revision as actual results are compared with past expectations and new estimates are made for the future. The schedule of funding progress, presented as required supplementary information, presents information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the AAL for benefits.

(c) Current Status of Plan (Unaudited)

Although still subject to audit, the July 1, 2009 actuarial study for the Water and Power Employees' Retirement, Disability, and Death Benefit Insurance Plan (the Plan) noted the market value of the Plan's assets were approximately \$5.699 billion and the unfunded actuarial accrued liability was approximately \$808 million. The Plan had unrecognized investment losses of \$1.6 billion as of June 30, 2009. The Plan employs a 5-year smoothing technique to value assets in order to reduce the volatility in contribution rates. The impact of this will result in "smoothed" assets that are lower or higher than the market value of the assets depending upon whether the remaining amount to be smoothed is either a net gain or a net loss. If the unrecognized investments losses were recognized immediately, required contributions to the Plan would increase from approximately 26.12% if covered payroll to 48.57% of covered payroll. Additionally, if the unrecognized investments losses were recognized immediately in the actuarial value of assets, the funded ratio of the Plan would decrease from 90% to 70%.

(12) Other Postemployment Benefit (Healthcare) Plan

(a) Plan Description

The Department provides certain healthcare benefits to active and retired employees and their dependents. The healthcare plan is administered by the Department. The Retirement Board and the Board have the authority to approve provisions and obligations. Eligibility for benefits for retired employees is dependent on a combination of age and service of the participants pursuant to a predetermined formula. Any changes to these provisions must be approved by the Retirement Board and the Board. The total number of active and retired department participants entitled to receive benefits was approximately 16,170 and 15,875 for the year ended June 30, 2009 and 2008, respectively.

The health plan is a single-employer defined benefit plan. During fiscal year 2007, the Retiree Health Benefits Fund (the Fund) was created to fund the postemployment benefits of the Department. The fund is administered as a trust and has its own financial statements. Such financial statements can be obtained from the Department of Water and Power Retirement Office, 111 N Hope, Room 357, Los Angeles, CA 90012.

(b) Funding Policy

The Department pays a monthly maximum subsidy of \$1,212 for medical and dental premiums depending on the employee's work location and benefits earned. Participants choosing plans with a cost in excess of the subsidy they are entitled to are required to pay the difference.

Although no formal funding policy has been established for the future benefits to be provided under this plan, the Department has made significant contributions into the Fund. In fiscal year 2009, the

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Department transferred \$100 million into the Fund and paid an additional \$59.5 million in retiree medical premiums. In fiscal year 2008, the Department transferred \$100 million in investments and cash into the Fund and paid an additional \$56.5 million in retiree medical premiums. The Power System's portion of these amounts was \$108.5 million and \$106.5 million for 2009 and 2008, respectively.

(c) Annual OPEB Cost and Net OPEB Obligation

The annual OPEB cost (expense) is calculated based on the employer ARC, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost under each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The following table shows the components of the Department's annual OPEB cost for the year, the amount actually contributed to the Plan, and changes in the net OPEB asset (amounts in thousands):

	Year ended June 30	
	2009	2008
Annual required contribution	\$ 60,976	40,145
Interest on net OPEB asset	(46,027)	(35,720)
Adjustment to annual required contribution	35,089	26,652
Annual OPEB costs	50,038	31,077
Contributions made	(159,522)	(156,546)
Change in net OPEB asset	(109,484)	(125,469)
Net OPEB asset – beginning of year	(556,214)	(430,745)
Net OPEB asset – end of year	\$ (665,698)	(556,214)

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The following table shows the components of the Power System's share in annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the net OPEB asset (amounts in thousands):

	Year ended June 30	
	2009	2008
Annual required contribution	\$ 41,464	27,298
Interest on net OPEB asset	(31,299)	(24,290)
Adjustment to annual required contribution	23,861	18,124
Annual OPEB costs	34,026	21,132
Contributions made	(108,525)	(106,541)
Change in net OPEB asset	(74,499)	(85,409)
Net OPEB asset – beginning of year	(381,462)	(296,053)
Net OPEB asset – end of year	<u><u>\$ (455,961)</u></u>	<u><u>(381,462)</u></u>

The Department's annual OPEB cost, the percentage of annual required contribution contributed to the Plan, and the net postemployment asset for fiscal years 2009, 2008, and 2007 were as follows (amounts in thousands):

	2009	2008	2007
Annual OPEB cost	\$ 50,038	31,077	81,670
Percentage of the ARC contributed	319%	504%	834%
Net postemployment asset	\$ 665,698	556,214	430,745

The Power System's share in the annual OPEB cost, the percentage of annual required contribution contributed to the Plan, and the net retirement asset for fiscal years 2009, 2008, and 2007 were as follows (amounts in thousands):

	2009	2008	2007
Annual OPEB cost	\$ 34,026	21,132	55,535
Percentage of the ARC contributed	319%	504%	833%
Net postemployment asset	\$ 455,961	381,462	296,053

(d) Funded Status and Funding Progress

As of July 1, 2008, the Department's actuarial value of assets was \$719.6 million, and Actuarial Accrued Liability (AAL) for benefits was \$1.4 billion, resulting in a Unfunded Actuarial Accrued Liability (UAAL) of \$638 million. The covered payroll (annual payroll of active employees covered by the Plan) was \$708.7 million, and the ratio of the UAAL to the covered payroll was 90%.

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As of July 1, 2007, the Department's actuarial value of assets was \$649.1 million, and Actuarial Accrued Liability (AAL) for benefits was \$1.0 billion, resulting in an Unfunded Actuarial Accrued Liability (UAAL) of \$393 million. The covered payroll (annual payroll of active employees covered by the Plan) was \$670.4 million, and the ratio of the UAAL to the covered payroll was 58%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the Plan and the annual required contributions of the Department are subject to continual revision as actual results are compared with past expectations and new estimates are made for the future. The schedule of funding progress, presented as required supplementary information, presents information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the AAL for benefits.

(e) Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan understood by the Department and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the Department and the plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in AAL and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the July 1, 2008 actuarial valuation, the entry-age normal cost method was used. The actuarial assumptions include 8.00% discount rate, which represents the expected long-term return on plan assets, an annual healthcare cost trend rate of 9.0% initially, reduced by decrements to an ultimate rate of 5.00% after eight years. Both rates include a 3.75% inflation assumption. The actuarial value of assets was determined using techniques that spread UAAL being amortized as a level percentage of projected payroll over a 27-year period.

In the July 1, 2007 actuarial valuation, the entry-age normal cost method was used. The actuarial assumptions include 8.00% discount rate, which represents the expected long-term return on plan assets, an annual healthcare cost trend rate of 8.5% initially, reduced by decrements to an ultimate rate of 5.00% after eight years. Both rates include a 3.75% inflation assumption. The actuarial value of assets was determined using techniques that spread UAAL being amortized as a level percentage of projected payroll over a 28-year period.

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(13) Other Long-Term Liabilities

(a) Other Long-Term Liabilities

The Power System has the following other long-term liabilities:

	Balance, July 1, 2008	Additions	Reductions	Balance, June 30, 2009
Accrued liabilities	\$ 31,340	—	(7,580)	23,760
Deferred credits:				
Purchased power	\$ 382,654	—	(50,812)	331,842
Public benefits	69,633	12,949	—	82,582
Rate stabilization	48,128	24,702	—	72,830
Other	3,021	—	(1,454)	1,567
	<u>\$ 503,436</u>	<u>37,651</u>	<u>(52,266)</u>	<u>488,821</u>
Accrued workers' compensation claims	<u>\$ 32,089</u>	<u>—</u>	<u>(2,961)</u>	<u>29,128</u>

	Balance, July 1, 2007	Additions	Reductions	Balance, June 30, 2008
Accrued liabilities	\$ 228,181	—	(196,841)	31,340
Deferred credits:				
Purchased power	\$ 457,629	—	(74,975)	382,654
Public benefits	38,215	31,418	—	69,633
Rate stabilization	—	48,128	—	48,128
Other	3,833	—	(812)	3,021
	<u>\$ 499,677</u>	<u>79,546</u>	<u>(75,787)</u>	<u>503,436</u>
Accrued workers' compensation claims	<u>\$ 28,368</u>	<u>3,721</u>	<u>—</u>	<u>32,089</u>

No portion of these liabilities is automatically due within one year.

(b) Accrued Liabilities

In June 2007, a tentative decision was awarded to certain public entities against the Department that claimed that they were charged more than their proportional share of the Department's capital costs in violation of Section 54999 of the Code. The Department accrued a liability of \$228.2 million as of June 30, 2007 relative to the court's tentative decision. However, in October 2008, the Department settled the case with the public entities, agreeing to pay them \$160 million through a combination of cash payments over a three-year period and bill credits over a 10-year period. As of June 30, 2009 and 2008, the Department has recorded \$7.6 million and \$128.7 million as accounts payable and \$31.3 million and \$23.4 million under long-term accrued liabilities, respectively.

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In addition, a long-term deferred debit for the settlement amount has been recognized since these costs will be recovered in the future (see note 14(d)ii).

Effective January 1, 2007, the California Legislature has amended Section 54999 of the Code, et seq., to clarify that, consistent with past practices, public agencies providing public utility service, such as the Department, may impose a reasonable fee, including a rate, charge, or other surcharge for any product, commodity, or service provided to a public agency and any public agency receiving service from such public agency providing public utility services will pay the imposed fee.

(c) *Deferred Credits*

The Department has deferred credits that are related to revenues collected from customers, but have not been fully earned. These funds are deferred and recognized as costs related to these deferrals are incurred.

Purchased Power Deferrals

During fiscal year 2006, the Board approved the suspension of deferring precollected purchased power costs and the reversal of the precollected purchased power costs recorded in prior years. The amount reversed is the cost of energy from IPP less the amount designated in rates for out-of-market purchased power costs. The reversal of the deferred credit is credited to retail sales. During fiscal years 2009 and 2008, the Power System reversed \$50.8 million and \$75.0 million, respectively, related to precollected purchase power costs. At June 30, 2009 and 2008, \$331.8 million and \$382.6 million, respectively, remain as part of deferred credits related to precollected purchased power costs.

Public Benefits

In accordance with Assembly Bill 1890, as amended by Assembly Bill 995 and pursuant to direction from the Board, a percentage of the Department's retail revenue is designated for use for qualifying public benefit 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. In accordance with current legislation and the Department's plans, the program is currently expected to cease on January 1, 2012.

The Department defers public benefits revenue from customers in excess of costs incurred under qualifying programs and defers qualifying expenses in excess of collections pursuant to approval received from the Board. During fiscal years 2009 and 2008, the Department spent \$52.2 million and \$33.1 million, respectively, on qualified public benefits programs. These programs include tree programs, investments in electric buses and vehicles, photovoltaics or solar power and other alternative energy sources, and support for low-income and life support customers. As of June 30, 2009 and 2008, the Department has recorded a deferred credit in the amount of \$82.6 million, and \$69.6 million due to public benefit expenses below revenues. Regulatory liabilities are reduced when

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adequate public benefit expenses are incurred, and regulatory assets are recovered when the corresponding revenue is earned.

Rate Stabilization Account

In April 2008, the City Council approved an amendment to the electric rate ordinance, which required the balance of the Rate Stabilization Account to be maintained separately from the Energy Cost Adjustment Account. The ordinance also directed that the deferred amount within the Energy Cost Adjustment Account be the beginning balance of the Rate Stabilization Account. As a result, \$24.5 million was reclassified from the Energy Cost Adjustment Account to the Rate Stabilization Account and \$23.6 million was deferred in fiscal year 2008. During fiscal year 2009, \$24.7 million was deferred from current year sales for resale. As of June 30, 2009 and 2008, the balance in the rate stabilization fund was \$72.8 million and \$48.1 million, respectively.

(d) Accrued Workers' Compensation Claims

Liabilities for unpaid workers' compensation claims are recorded at their present value when they are probable of occurrence and the amount can be reasonably estimated. The liability is actuarially determined, based on an estimate of the present value of the claims outstanding and an amount for claim events incurred but not reported based upon the Department's loss experience, less the amount of claims and settlements paid to date. The discount rate used to calculate this liability at its present value was 4% at June 30, 2009 and 2008. The Department has third-party insurance coverage for workers' compensation claims in excess of \$1 million.

Overall indicated reserves for workers' compensation claims, for both the Water System and the Power System, undiscounted, have decreased from \$57.7 million as of June 30, 2008 to \$53.0 million as of June 30, 2009. This decrease is mainly attributable to a downward trend in the number of cases filed at the Department and the utility industry. The increase in the June 30, 2008 liability was due to a significant number of cases that were reopened during fiscal year 2007 – 2008. As the claims typically take longer than one year to settle and close out, the entire discounted liability is shown as long-term on the balance sheets as of June 30, 2009 and 2008.

Changes in the Department's undiscounted liability since June 30, 2007 are summarized as follows (amounts in thousands):

		June 30		
		2009	2008	2007
Balance at beginning of year	\$	57,757	49,669	61,173
Current year claims and changes in estimates		15,053	28,238	7,409
Payments applied		(19,773)	(20,150)	(18,913)
Balance at end of year	\$	<u>53,037</u>	<u>57,757</u>	<u>49,669</u>

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The Power System's portion of the discounted reserves as of June 30, 2009 and 2008 is \$29.1 million and \$32.1 million, respectively.

(14) Commitments and Contingencies

(a) *Transfers to the Reserve Fund of the City of Los Angeles*

Under the provisions of the City Charter, the Power System 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 the increase in fund net assets before transfers to the reserve fund of the City of the prior fiscal year. Such payments are not in lieu of taxes and are recorded as a transfer in the statements of revenues, expenses, and changes in fund net assets.

The Department authorized total transfers of \$223 million and \$182 million in fiscal years 2009 and 2008, respectively, from the Power System to the reserve fund of the City.

(b) *Palo Verde Nuclear Generating Station (PVNGS) Matters*

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 (the DOE) is to develop 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 an ongoing litigation with respect to the DOE's ability to accept spent nuclear fuel; however, no permanent resolution has been reached. Capacity in existing fuel storage pools at PVNGS was exhausted in 2003. A Dry Cask Storage Facility (also called the Independent Spent Fuel Storage Facility) was built and completed in 2003 at a total cost of \$33.9 million (about \$3.3 million for the Department). The facility has the capacity to store all the spent fuel generated by the plant until the end of its life in 2026. The Department accrues 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.

The Price-Anderson Act (the Act) requires that all utilities with nuclear generating facilities share in payment for claims resulting from a nuclear incident. Participants in PVNGS currently insure potential claims and liability through commercial insurance with a \$300 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 a maximum of \$100.6 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 5.70% direct interest and its 3.95% indirect investment interest through SCPPA, the Department would be responsible for a maximum assessment of \$9 million per incident, limited to payments of \$1 million per incident annually.

(c) *Environmental Matters*

Numerous environmental laws and regulations affect the Power System's facilities and operations. The Department monitors its compliance with laws and regulations and reviews its remediation

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obligations on an ongoing basis. The following topics highlight some of the major environmental compliance issues affecting the Power System:

Air Quality – Nitrogen Oxide (NOx) Emissions

The Power System's generating station facilities are subject to the Regional Clean Air Incentives Market (RECLAIM) NOx emission reduction program adopted by the South Coast Air Quality Management District (SCAQMD). In accordance with this program, SCAQMD established annual NOx allocations for NOx RECLAIM facilities based on historical emissions and type of emission sources operated. These allocations are in the form of RECLAIM trading emission credits (RTCs). Facilities that exceed their allocations may buy RTCs from other companies that have emissions below their allocations. The Department has a program of installing emission controls and purchasing RTCs, as necessary, to meet its emission requirements.

As a result of the installation of NOx control equipment and the repowering of existing units, the Department has sufficient RTCs to meet its native load requirements for normal operations.

Air Quality – Greenhouse Gas Emissions

In September 2006, Governor Schwarzenegger signed into law Assembly Bill 32, the California Global Warming Solutions Act of 2006 (Nunez, Chapter 488, Statutes of 2006). The bill requires the California Air Resources Board to develop regulations and market mechanisms that will ultimately reduce California's greenhouse gas emissions to 1990 levels by 2020, or approximately 30% from business-as-usual emission levels for 2020. Mandatory declining greenhouse gas emission caps will begin in 2012 for significant sources and be gradually reduced to meet the 2020 goals. As specified in the bill, all emissions from electricity that is consumed in the state, whether it is generated in California or in other states, will be subject to the cap. As a result, the Power System's share of emissions from IPP and other facilities outside California will be subject to this program. In December 2008, the California Air Resources Board adopted a Climate Change Scoping Plan, pursuant to AB 32. The Scoping Plan includes a number of strategies that will apply to the electricity sector, including 1) California cap-and-trade program linked to the Western Climate Initiative, 2) energy efficiency, and 3) renewable energy.

At the federal level, H.R. 2454, the American Clean Energy and Security Act was passed by the U.S. House of Representatives in June 2009. H.R. 2454 proposes a federal greenhouse gas cap-and-trade program, a national renewable energy standard, and energy efficiency requirements, among other measures to reduce greenhouse gas emissions across the economy. The U.S. Senate released similar climate change legislation on September 30, 2009. A federal cap-and-trade program may be established in the same time frame (2012) as a state cap-and-trade program, and may or may not include a moratorium that prohibits implementation of a state program prior to 2017. As such, it is possible that there may be a state program combined with or superseded by a federal program.

It is uncertain at this time what impact a state program and/or federal program will have on the Power System's operations. If a state and/or federal cap-and-trade program is established, the primary issue will be the relationship between the declining cap and how allowances will be allocated to the Department and other power producers or auctioned. The target date for the Air

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Resources Board to adopt regulations is January 1, 2011. The goal of the regulations would be to “achieve the maximum technologically feasible and cost-effective reductions in greenhouse gas, including provisions for using both market mechanisms and alternative compliance mechanisms.” The Department is actively participating in the rule making process.

SB 1368 was signed into law on September 29, 2006 and requires the California Public Utilities Commission (CPUC) and the California Energy Commission (CEC) to establish a greenhouse gases emissions performance standard and implement regulations for all long-term financial commitments in base load generation made by load serving entities (LSEs) and local publicly owned electric utilities (POUs), respectively. The greenhouse gas emissions performance standard is not to exceed the rate of greenhouse gases emitted per MW hour associated with combined-cycle, gas turbine base load generation. The regulations have been adopted by the CPUC for investor-owned utilities and by the CEC for publicly owned utilities and establish an emissions performance standard of 1,100 pounds of carbon dioxide per MW hour of electricity.

Power Plant Once-Through Cooling Water Systems

Once-through cooling (OTC) is the process where water is drawn from a source, pumped through equipment to provide cooling, and then discharged. Some type of cooling process is necessary for nearly every type of traditional electrical generating station, and the once-through cooling process is utilized by many electrical generating stations located next to large bodies of water. Typically, the water used for cooling is not chemically changed in the process although its temperature is increased.

Due to the Second Circuit Court’s decision to remand most of Environmental Protection Agency’s (EPA) 316(b) Rule finalized in July 2004, EPA suspended this Rule and is in the process of drafting a new rule. In the absence of EPA’s 316(b) Rule, the California State Water Resources Control Board decided to move forward and is in the process of developing their own state-wide once-through cooling policy. The State wide draft policy was released in June 2009 and is expected to be adopted in December 2009. This rule will require OTC plants to reduce OTC by 93% – equivalent to wet cooling towers using seawater. This is referred to as the Track 1 compliance path. If the Track 1 compliance path is found to be infeasible, with concurrence from the Regional Board, a Track 2 compliance path can be pursued which requires that the cooling water intake structure (CWIS) achieve an impingement mortality and entrainment (IM/E) reduction level of 90% of the Track 1 compliance standard or 84.7%. The track 2 compliance standard requires the protection of aquatic organisms 200 microns and larger, and currently there is only technology available that can control aquatic life 500 microns or larger. A cost-benefit variance is available for those repowered units meeting a certain heat rate, if the cost of compliance is wholly disproportionate to the environmental benefits to be gained. Variance approval by the Regional Board allows a facility to install the best performing IM/E control technology whose costs are not wholly disproportionate to the environmental benefits. Any difference between technology performance and the state standard (84.7%) must be fully mitigated. The compliance deadline stated in the State wide draft policy for LADWP facilities are: HnGS 2015: HGS and SGS 2017. Beginning in 2015, interim measures must be in place till the facility is in compliance with the Policy. In addition, other regulatory changes have been made that could significantly impact operations at the Haynes, Scattergood, and Harbor Generating Stations. The Regional Water Quality Control Board reclassified the body of water that

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the once-through cooling water is discharged to for the Harbor Generating Station, and sent a letter of intent to reclassify the body of water for the Haynes Generating Station discharge. Even though the Haynes Generating Station will be repowering existing units, should there be a reclassification for the water body discharges at the Haynes Generating Station, there will be requirements that cannot be met with its existing cooling or future repowered configuration. The Department is in the process of reviewing the regulations and conducting studies. Once the studies are reviewed, the Department will determine an appropriate course of action.

(d) *Litigation*

i. California Receivables and Refund Hearings

During fiscal year 2001, the Power System made sales to two California agencies that were formed by Assembly Bill 1890 to facilitate the purchase and sale of energy and ancillary services in the state of California. Through June 30, 2009, these agencies, the CAISO and the CPX, have made minimal payments since April 2001 on amounts outstanding to counterparties, including the Power System, for certain energy purchases in fiscal years 2000 and 2001. The CPX filed for protection under Chapter 11 of the Federal Bankruptcy Statute in January 2001. Two utilities with significant amounts due to these agencies have paid all amounts due to the CPX; however, the amounts remain in an escrow account pending the resolution of disbursement of the funds.

As of June 30, 2009 and 2008, a total of \$166.3 million was due to the Power System from the CAISO and the CPX. Claims have been filed questioning whether amounts charged for energy sold to the CAISO and the CPX during 2000 and 2001 represent “unlawful profits” that should be subject to refund. The Courts have opined that FERC has no jurisdiction over the Department; however, the Courts have stated that the California parties seeking the refund may have a cause of action. As such, the litigation in this area is continuing.

The Power System has recorded a \$50.0 million liability as of June 30, 2009 and 2008 against the \$166.3 million receivable, for potential refunds pertaining to its wholesale sales during 2000 and 2001. Management believes that this is the most probable amount that will be refunded by the Power System and is based on the most recent formula disclosed by FERC. While management has recorded its estimate of the most probable amounts that will be refunded, management does believe that it is entitled to all amounts due from sales to counterparties in California, including those named above. Furthermore, management believes that interest may be due to it on those amounts but any potential receivable is not estimable at this time. In addition, management does not believe that the Power System’s exposure to any additional losses with respect to these receivable balances is currently estimable. If final settlement of these receivables results in an amount less than the recorded balance, net of the \$50.0 million liability recorded, the Department will be required to record a loss in future periods.

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ii. Capital Facilities Fee Claims

In June 2007, the Department received a tentative decision in favor of the state and a number of local government agencies that are electric customers of the Department that claimed that the Department has rates that include a capital facilities' charge that violates the state's statute. However, in October 2008, the Department settled the case and recorded the \$160 million settlement amount. Additionally, as permitted by SFAS No. 71, the Board approved to defer all potential costs associated with the resolution of this litigation and establish a corresponding long-term deferred debit to be recovered through future revenues over a period of up to 10 years, if necessary (see note 13(b)).

iii. Other

A number of claims and suits are also 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, is not expected to materially impact the Power System's financial position, results of operations, or cash flows as of June 30, 2009.

(e) Risk Management

The Power System is subject to certain business risks common to the utility industry. The majority of these risks are mitigated by external insurance coverage obtained by the Power System. For other significant business risks, however, the Power System has elected to self-insure. Management believes that exposure to loss arising out of self-insured business risks will not materially impact the Power System's financial position, results of operations, or cash flows as of June 30, 2009.

(f) Credit Risk

Financial instruments, which potentially expose the Power System to concentrations of credit risk, consist primarily of retail and wholesale receivables. The Power System's retail customer base is concentrated among commercial, industrial, residential, and governmental customers located within the City. Although the Power System is directly affected by the City's economy, management does not believe significant credit risk exists at June 30, 2009, except as provided in the allowance for losses. The Power System manages its credit exposure by requiring credit enhancements from certain customers and through procedures designed to identify and monitor credit risk.

**LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM**

Required Supplementary Information

June 30, 2009

Pension Plan – Schedule of Funding Progress

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 the Water System and the Power System (amounts in thousands):

Actuarial valuation date July 1	Actuarial value of assets	Actuarial accrued liability (AAL)	Unfunded AAL (UAAL)	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
2008	\$ 7,247,853	7,619,103	371,250	95%	\$ 708,732	52%
2007	6,864,084	7,467,285	603,201	92	670,373	90
2006	6,447,763	7,046,571	598,808	92	635,728	94

Postemployment Healthcare Plan – Schedule of Funding Progress

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 the Water System and the Power System (amounts in thousands):

Actuarial valuation date July 1	Actuarial value of assets	Actuarial accrued liability (AAL)	Unfunded AAL (UAAL)	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
2008	\$ 719,637	1,358,103	638,467	53%	\$ 708,732	90%
2007	649,116	1,041,722	392,606	62	670,400	58
2006	—	1,053,853	1,053,853	—	635,700	166