SMUD
SACRAMENTO MUNICIPAL UTILITY DISTRICT
The Power To Do More.®

P.O. Box 15830, Sacramento, CA 95852-1830; 1-888-742-SMUD (7683)

NQA 08-018

June 17, 2008

U.S. Nuclear Regulatory Commission
Document Control Desk
Washington, DC 20555

Docket No. 50-312
Rancho Seco Nuclear Generating Station
License No. DPR-54

Docket No. 72-11
Rancho Seco Independent Spent Fuel Storage Installation
License No. SNM-2510

ANNUAL FINANCIAL REPORT

Attention: John Hickman and Randy Hall

In accordance with 10 CFR 50.71(b) and 10 CFR 72.80(b), we are submitting the 2007 annual financial report for the Sacramento Municipal Utility District. If you or members of your staff have questions requiring additional information or clarification, please contact me at (916) 732-4843.

Sincerely,

Robert E. Jones
Supervising Quality Engineer

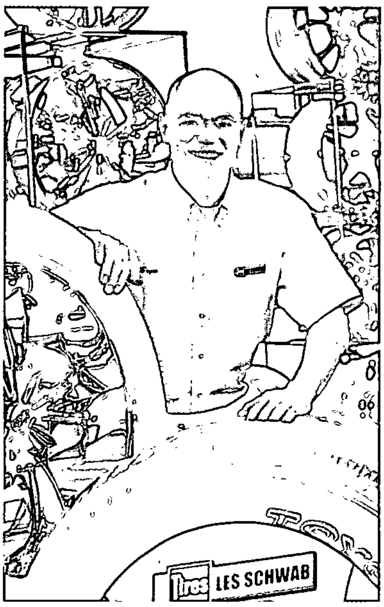
Cc: NRC, Region VI

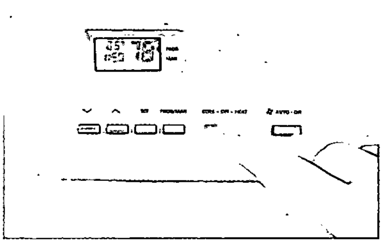
M004
FSME

SACRAMENTO MUNICIPAL UTILITY DISTRICT

2007 Annual Report

Compact with the Customer





Statistics **2007**

Service area population:
1.4 million

Total operating revenue:
$1.31 billion

Employees (year end):
2,226

Record peak demand:
3,299 megawatts
July 24, 2006

Number of customers (year end):
589,599

Credit Rating:
A Standard & Poor's
A1 Moody's
A Fitch

Executive Management

Jan E. Schori
General Manager and
Chief Executive Officer

James R. Shetler
Assistant General Manager,
Energy Supply

John DiStasio
Assistant General Manager,
Energy Delivery & Customer Services

Betty Masuoka
Assistant General Manager,
Administrative Services

Arlen Orchard
General Counsel and Secretary

James A. Tracy
Chief Financial Officer

Noreen Roche-Carter
Treasurer

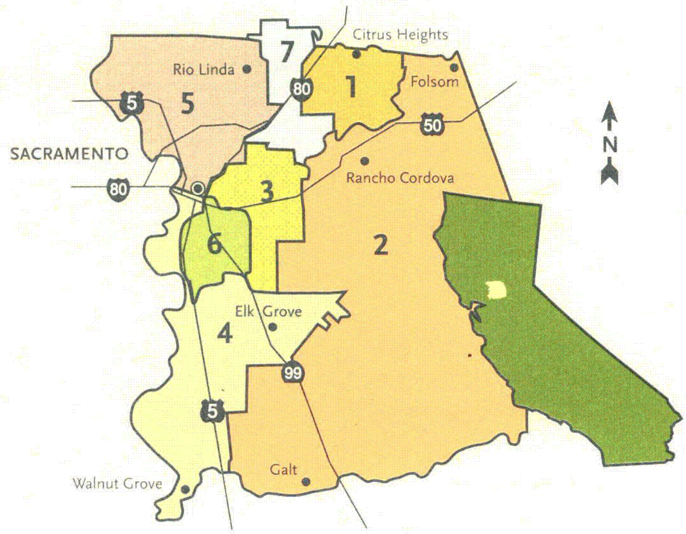
Cary M. Nethaway
Controller

Linda Carey Johnson
Chief Information Officer

Table of contents

SMUD Service Area and Board Member Wards

SMUD generates, transmits and distributes electric power to a 900-square-mile territory that includes California's capital city, Sacramento County and a small portion of Placer County. As a municipal utility, SMUD is governed by a seven-member board of directors elected by the voters to staggered four-year terms. The SMUD Board of Directors determines policy for the District and appoints the general manager, who is responsible for the District's operations.



SMUD Board of Directors

Renee Taylor
Ward 1

Susan Patterson
Ward 2
President 2007

Howard Posner
Ward 3
Vice President 2007
Vice President 2008

Genevieve Shiroma
Ward 4

Peter R. Keat
Ward 5

Larry Carr
Ward 6
President 2008

Bill Slaton
Ward 7

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Produced by: Communication & Advertising Services

In 2007, SMUD laid the groundwork for a new way of doing business. To meet the Sacramento region's growing energy needs while safe-guarding the environment, the SMUD Board of Directors initiated a process to develop a new **"Compact with the Customer."**

Jan Schori
SMUD General Manager

General Manager's Message

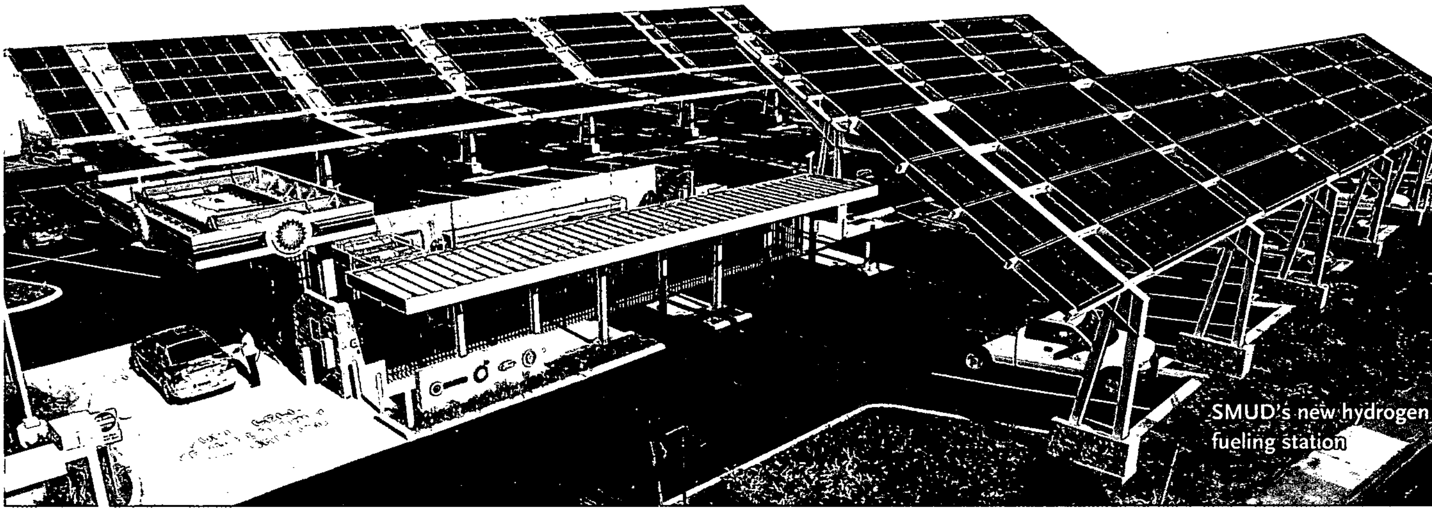
Sacramento County is expected to grow by nearly 1 million residents by 2050. SMUD's load-serving capability must grow as well, particularly during the peak hours of summer use. But Sacramento's air quality is already among the worst in the country. Siting new fossil-fuel power plants will be extremely difficult if not impossible. The developing greenhouse gas reduction regulations soon to be promulgated by the State of California will also significantly constrain traditional fossil generation solutions to meeting customers' peak load needs.

The Compact with the Customer tackles these issues head on. To help better reflect the high cost of serving energy use on peak and its environmental consequences, the Board of Directors is considering implementation of time-differentiated rates that match the actual cost of electricity. These rates should encourage customers to shift use to off-peak hours and conserve during high use, high cost periods. Large commercial customers have such rates now; SMUD wants to partner with all customers to improve energy efficiency and conservation with the goal of helping them to save money and the environment. We started the process of educating our customers about energy efficiency and pricing options by holding numerous focus groups with residential and commercial customers.

While it's clear there's a need for extensive customer education to develop the understanding necessary to achieve the goal of

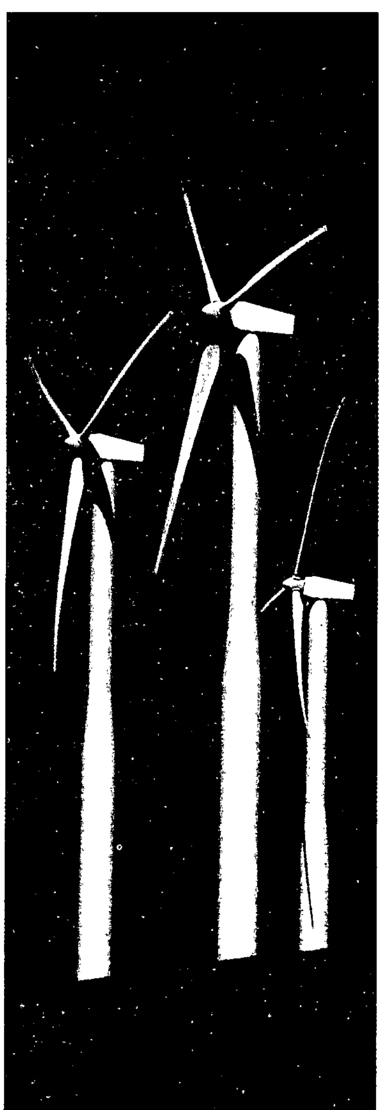
In both 2007 and 2008, SMUD received the highest commercial customer satisfaction score of any electric utility in the country from J.D. Power and Associates.

SMUD's Solano Wind Project is a growing source of clean energy



SMUD's new hydrogen fueling station

For 2008, the Board has approved a new financial target based on cash flow. The new rates for 2008 – a 7-percent increase on Jan. 1 – were set by the Board to meet this new target and cover the new efficiency and solar programs.



peak use reduction, customers are open to SMUD's proposal and willing to partner with SMUD to address the community's needs in an environmentally responsible way. The Board adopted the most aggressive energy efficiency goal in the state – helping our customers reduce their energy consumption by 15 percent over the next 10 years – exceeding the state requirements by 50 percent.

SMUD remains one of the cleanest electric utilities in the country. In 2007, we took several significant steps toward meeting California's renewable energy requirements. Our wind farm in Solano County now generates more than 100 megawatts of green power, and we're on track to meet the standards set forth in the state solar PV initiative. We are well ahead of schedule in making progress towards our 2011 renewable portfolio goal of 23 percent (excluding large hydro).

2007 was a below-average year for hydroelectric generation, both from SMUD's Upper American River Project and the federal government's Central Valley Project. (SMUD remains the largest federal power customer in Northern California, with approximately 30 percent of the CVP's output.) The regional economy also slowed down measurably. As a result, SMUD posted a net loss of $4.6 million in 2007.

Looking forward to 2008, the Board has approved a new financial target based on cash flow. The new rates for 2008 – a 7-percent increase on Jan. 1 – were set by the Board to meet this new target and cover the new efficiency and solar programs.

In both 2007 and 2008, SMUD received the highest commercial customer satisfaction score of any electric utility in the country from J.D. Power and Associates. We continue to have a strong relationship with our customers. But the health of the organization and our community demands that we move beyond the traditional metrics of customer satisfaction – affordable, reliable electricity – to increased customer engagement and a new partnership to meet our future needs. This report looks at some of the ways we're doing precisely that.

Sincerely,

Jan Schori

Jan Schori

Year in Review 2007

January

In becoming SMUD's first Solar Partner, the city of Elk Grove made it easier for residential customers to install solar systems on their homes. Elk Grove agreed to waive permit fees and review residential solar applications in one day. By the end of the year, each of the county's other jurisdictions – the cities of Sacramento, Galt, Folsom, Rancho Cordova, Citrus Heights, along with the county of Sacramento – followed Elk Grove's lead and became SMUD Solar Partners.

After more than five years of research and negotiation, SMUD and more than a dozen organizations endorsed a settlement agreement regarding how SMUD will run its hydroelectric power plants on the upper American River for the next 30 to 50 years. The Upper American River Project generates about 15 percent of SMUD's electricity in a normal water year.

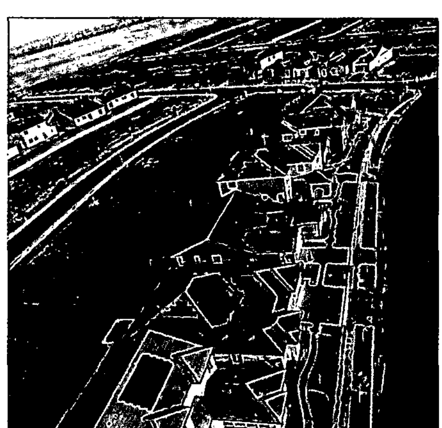
February

Construction began on a hydrogen fueling station on SMUD's downtown campus. Funded by SMUD and BP, the refueling station was completed in early 2008. Photovoltaic panels provide renewable electricity to produce the hydrogen for the demonstration cars.

March

SMUD scored No. 1 in the nation in the J.D. Power and Associates survey measuring business customers' satisfaction with large electric utilities. SMUD's overall satisfaction score climbed nearly 10 percent from the previous survey.

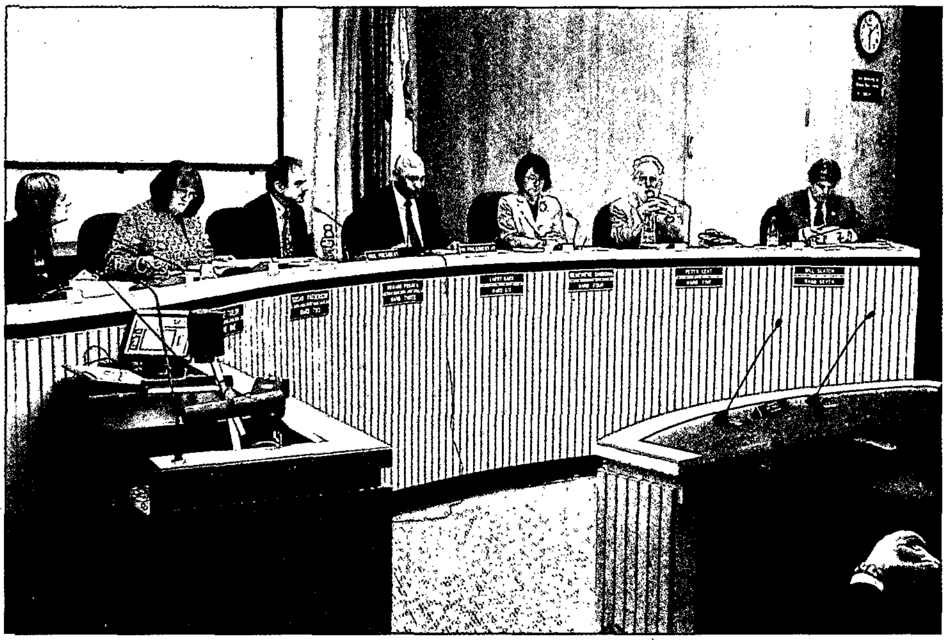
SMUD and Lennar Homes entered into the largest solar new home partnership in the country. More than 1,200 super energy-efficient, solar-powered Lennar homes will be built in SMUD's service territory by 2010.



April

The American Public Power Association awarded SMUD its "Reliable Public Power Provider" platinum award. APPA, the national service organization for more than 2,000 community-owned electric utilities, rates utilities in four vital areas: reliability, safety, training and system improvement. SMUD scored 98.5 points out of a possible 100.

SMUD became the first utility in the country to receive top honors in Leadership in Energy and Environmental Design from the U.S. Green Building Council. SMUD's Customer Service Center received platinum designation for its energy-efficient design.



May

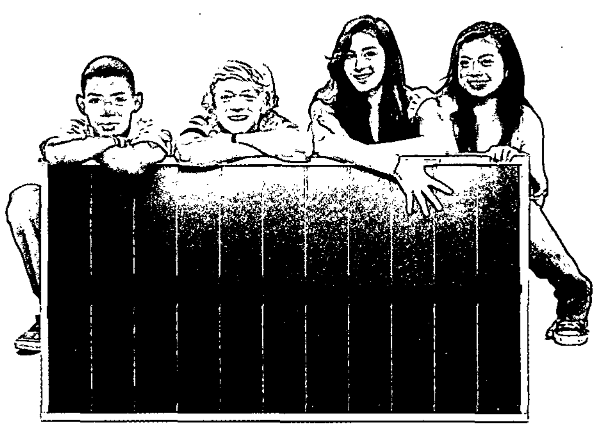
SMUD's Board of Directors voted to approve energy efficiency goals that exceed state requirements by 50 percent. SMUD will help customers reduce energy consumption by 15 percent over the next 10 years. The higher level of efficiency would reduce peak generation requirements by 570 megawatts by 2017.

June

Four local high schools will share $25,000 to develop solar projects as part of SMUD's Energize Minds for Solar Design grant program. The annual grants will help educate the next generation of energy consumers and spur students' interest in science.

July

More low-income customers became eligible for SMUD's Energy Assistance Program Rate. Families with household incomes that don't exceed 200 percent of the federal poverty level can save more than 30 percent on their monthly electric bills.



August

SMUD again scored higher than any other electric utility in California in an annual J.D. Power and Associates survey of residential customers. SMUD's score was the third best in the nation, up from fifth best in 2006. It marked the seventh time in eight years that SMUD was the highest scoring electric utility in California in this survey.

SMUD's interactive voice response (IVR) system ranked first in the West and fourth nationally in a benchmark study conducted by E Source, an independent energy analyst. E Source assessed the IVR systems of 103 gas and electric utilities. SMUD received 836 out of a possible 1,000 points in the survey.

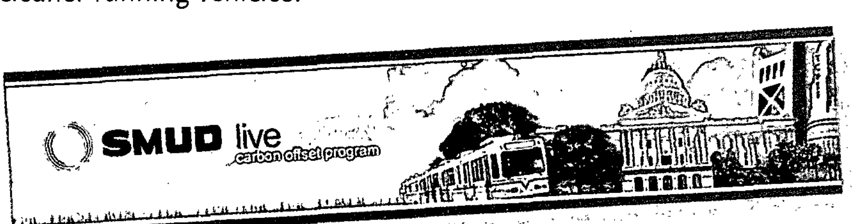
SMUD's Energize Minds for Solar Design grant program helps educate the next generation of energy consumers.

September

The SMUD Board approved a pilot program in which SMUD customers will be able buy blocks of photovoltaic power, giving them a "virtual" solar system. The "SolarShares" program is the first of its kind in California.

October

SMUD launched OurGreenCommunity.org, a Web site that includes a carbon calculator and carbon offset program. The interactive site provides customers with valuable information on energy efficiency, renewable resources and cleaner-running vehicles.



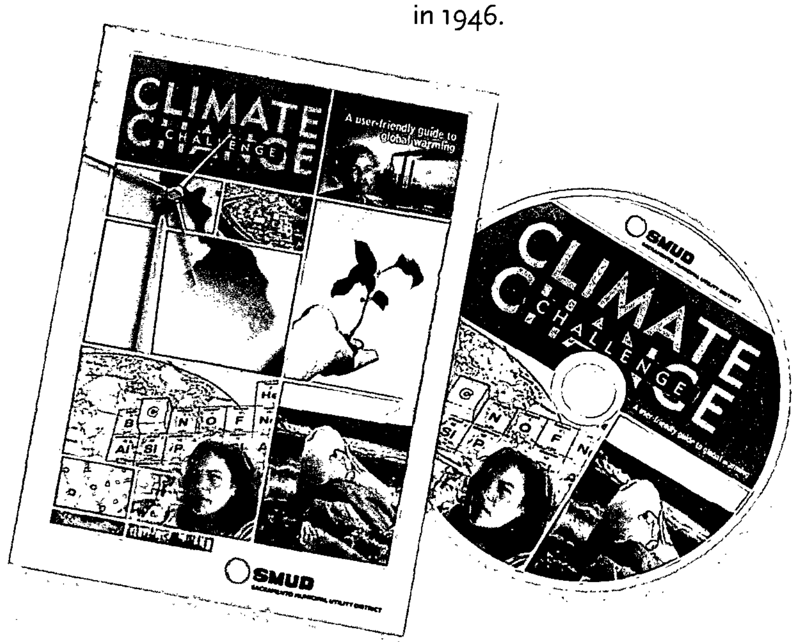
Jan Schori announced that she would retire after 14 distinguished years of service as SMUD's general manager.

November

The SMUD Board appointed Renee Nunes Taylor to fill the Ward 1 vacancy left open after Linda Anderson Davis resigned in October. Ward 1 includes the communities of Fair Oaks, Citrus Heights, Orangevale and Foothill Farms.

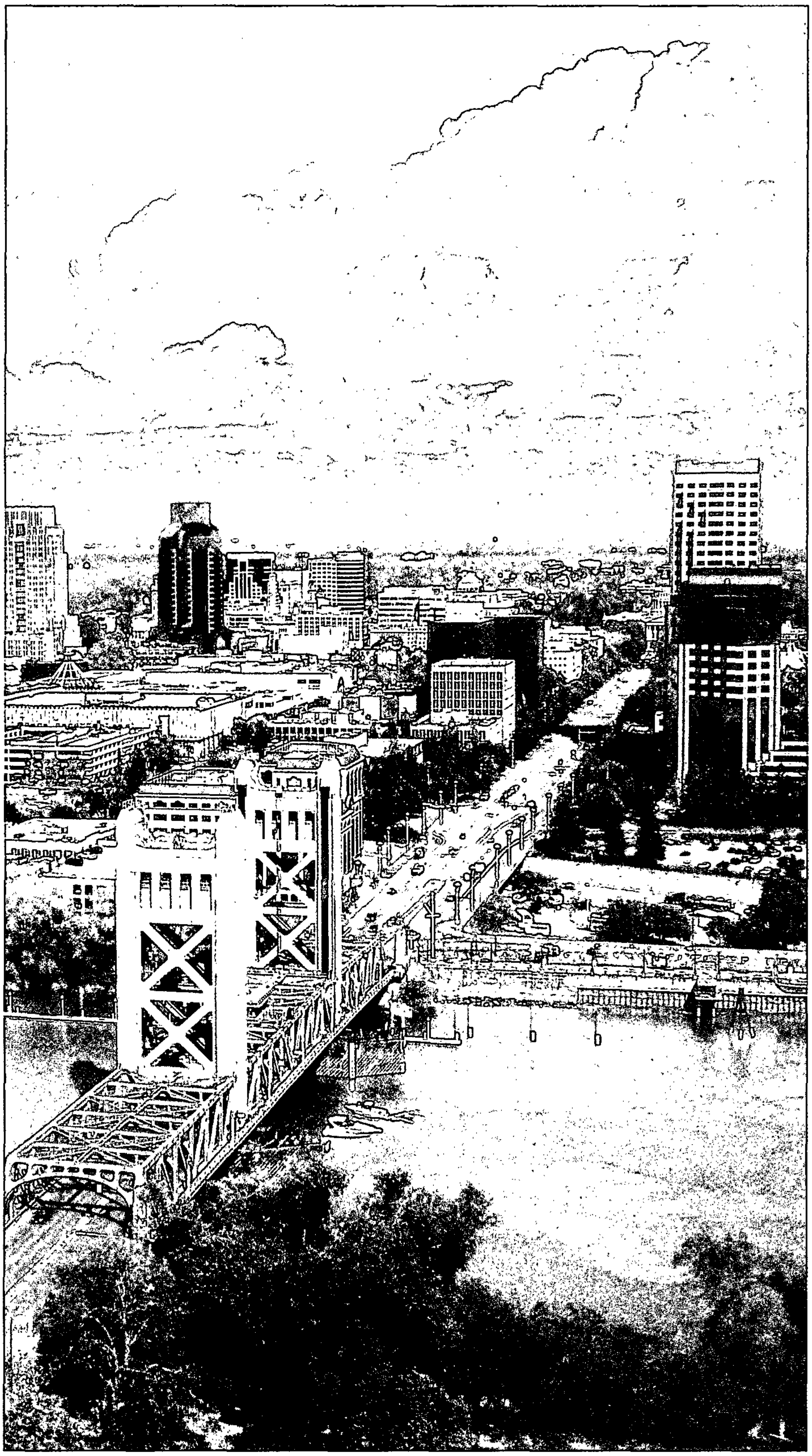
December

SMUD General Manager Jan Schori announced that she will retire following the Board's appointment of a successor in 2008. Schori served 14 years as general manager, the longest tenure of any GM since SMUD began serving Sacramento in 1946.



"Climate Challenge," an educational DVD produced for Sacramento-area students, is distributed to more than 1,200 teachers throughout SMUD's service territory. The video provides an overview of global warming and suggests ways for students to reduce their energy use.

SMUD's vision is to empower our customers with solutions and options that increase energy efficiency, protect the environment, reduce global warming and lower the cost to serve our region.



By 2050, Sacramento County's population is projected to increase by 1 million residents. SMUD and its 590,000 electric customers don't have to look that far ahead, however, to see the effects of growth on Sacramento's energy use and air quality.

To balance the region's growing energy needs while protecting the environment and reducing global warming, the SMUD Board of Directors is developing a "Compact with the Customer."

Curbing energy use during the hottest hours of summer is the major impetus. SMUD currently needs an extra 400 megawatts of power to satisfy peak energy use during the 40 hottest hours of the summer. If trends continue, SMUD would need an extra 650 megawatts of power to meet the summer peak in 2050.

It's going to be a challenge to get customers to be more aware of how they use energy and convince them to change old habits. But society needs to do this in order to have a more sustainable environment.

The objectives of the Compact with the Customer can be summed up in the vision statement that the SMUD Board adopted in 2006: SMUD's vision is to empower our customers with solutions and options that increase energy efficiency, protect the environment, reduce global warming and lower the cost to serve our region.

By tackling peak energy use and carbon emissions head on, SMUD's Compact with the Customer will help ensure a more sustainable world for future generations.

Compact with the Customer

The Compact with the Customer takes a variety of approaches. SMUD will boost its supplies of renewable energy and become one of the most energy-efficient regions in the state through new programs and rate signals. SMUD is taking a broad look at rates and how it can use two-way meters to give price signals to customers and encourage them to reduce their energy use.

Studies have found a link between time-of-use pricing and reduced energy use. A California Energy Commission study found that peak demand went down 16 percent with time-of-use pricing.

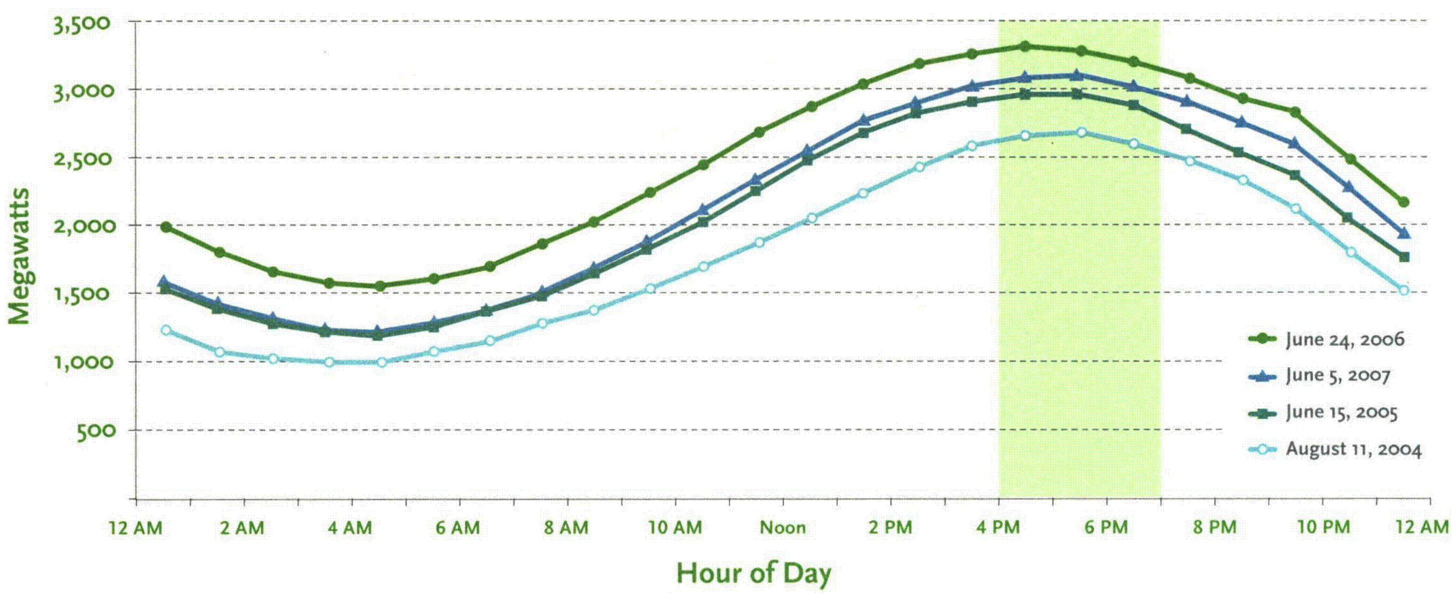
Whether they're motivated by environmental concerns or simply want to save money, customers need to become active managers of their energy use. That's why the SMUD Board chose to steer a new path. The Board recognized that our current pricing structures don't reflect what it costs to provide power during those peak hours of summer.

By offering new and redesigned energy efficiency programs, SMUD can also help customers reduce their peak use.

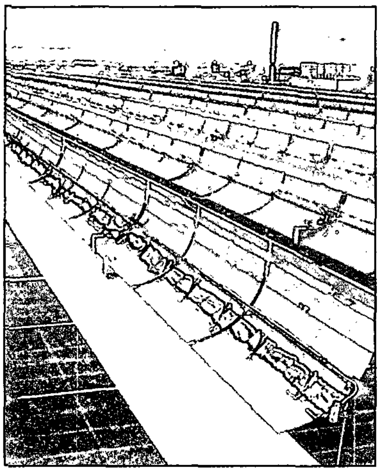
The Compact with the Customer is not a big-bang initiative. It will be rolled out over the next several years, involving customers each step of the way. The Compact with the Customer is just that – a mutually beneficial agreement with the people SMUD has served for more than 60 years.

SMUD needs an extra 400 megawatts of power to satisfy peak energy use during the 40 hottest hours of summer. The chart below shows the dramatic spike in energy use on the most energy-intensive days of the last four years.

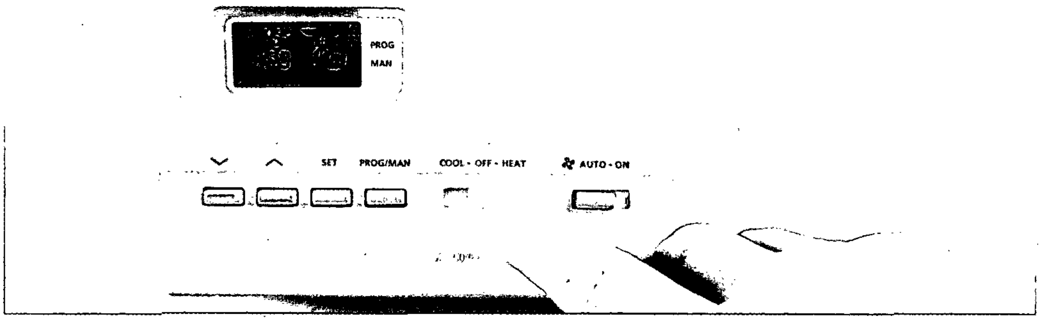
Peak Power Usage SMUD Peak Days 2004 – 2007



As part of the Compact with the Customer, SMUD organized approximately 30 focus groups across all customer segments from September to December. The main purpose of the meetings was to gather customer reactions to new pricing and service concepts.



This will not be a one-size-fits-all proposition. SMUD is completely redesigning its energy efficiency programs and will develop more ways for customers to buy solar power and support more renewable generation.



While they're willing to reduce their energy use, most customers expressed a desire to retain control of their thermostats.

As part of the Compact with the Customer, SMUD organized approximately 30 focus groups across all customer segments from September to December. The main purpose of the meetings was to gather customer reactions to new pricing and service concepts.

Many local businesses said they understand the challenges SMUD faces, and these commercial customers expressed a willingness to work with their utility to find mutual solutions to Sacramento's growing energy needs.

Rather than having to choose between "bundled" packages of options, business customers said they'd prefer to customize their selection of billing concepts, energy efficiency measures and demand-response programs. Facility managers representing large commercial customers were skeptical about making changes not driven by the bottom line.

While some business owners said they might be able to shift energy use away from the "super peak" hours in the summer – 4 p.m. to 7 p.m. – others expressed doubts given the nature of their businesses.

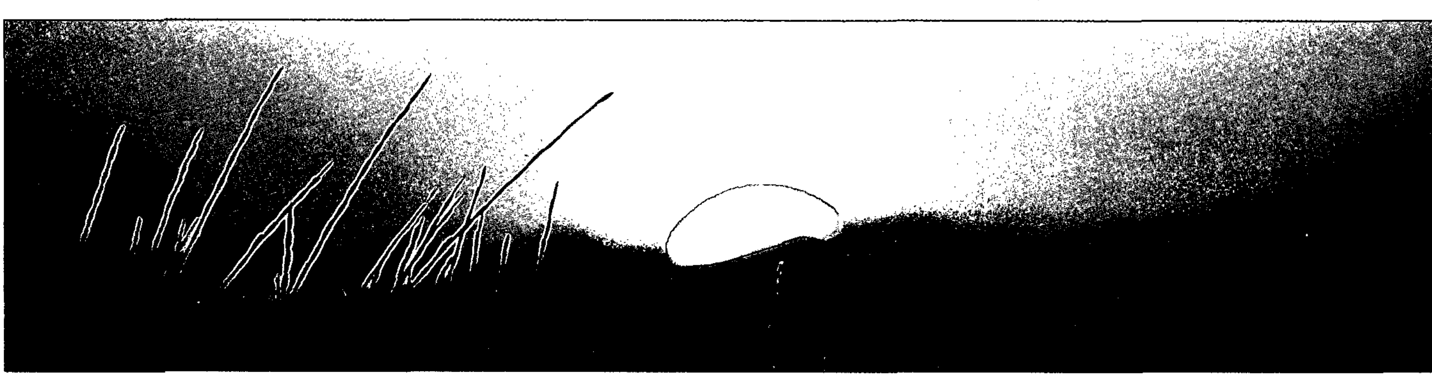
Listening to Customers

Most residential customers in the focus groups understood that the cost of supplying energy is higher in the hot summer months when air conditioners work overtime. While willing to reduce their energy use, most wanted to retain control of their air conditioners and thermostats.

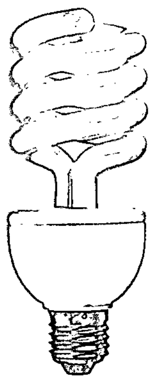
Commercial customers expressed a willingness to partner with SMUD in making Sacramento a more sustainable community. Commercial customers favored options in choosing the pricing and programs that best suit their businesses.

The information obtained from the focus groups will be used to design programs for energy efficiency. In general, customers said they want to learn more about their best energy-saving options, and SMUD will work toward educating them in the next year and beyond.

Customer service representatives perform a valuable service in keeping SMUD customers informed.

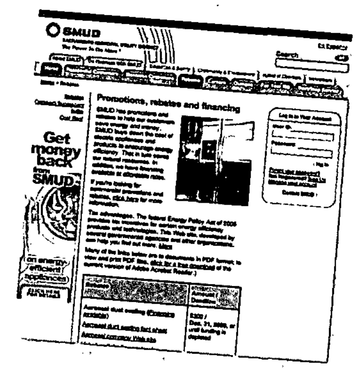


SMUD plans to exceed the state's energy efficiency requirements by 50 percent. California is requiring that electric utilities reduce energy consumption by 1 percent in each of the next 10 years.



Switching to compact fluorescent light bulbs is one of the cheapest, easiest ways to reduce energy use.

With the Sacramento Tree Foundation, SMUD has planted 430,000 free shade trees since the program's inception in 1990. Fully grown, properly placed trees can cut home cooling costs by up to 40 percent.



SMUD offers rebates on a wide range of energy-efficient appliances.

Using Energy More Efficiently

SMUD plans to exceed the state's energy efficiency requirements by 50 percent. California is requiring that electric utilities reduce energy consumption by 1 percent in each of the next 10 years.

SMUD will help customers reduce total energy consumption by 15 percent over the next 10 years. The higher level of efficiency will reduce peak generation by 570 megawatts by 2017 – an amount greater than the capacity of SMUD's Cosumnes Power Plant.

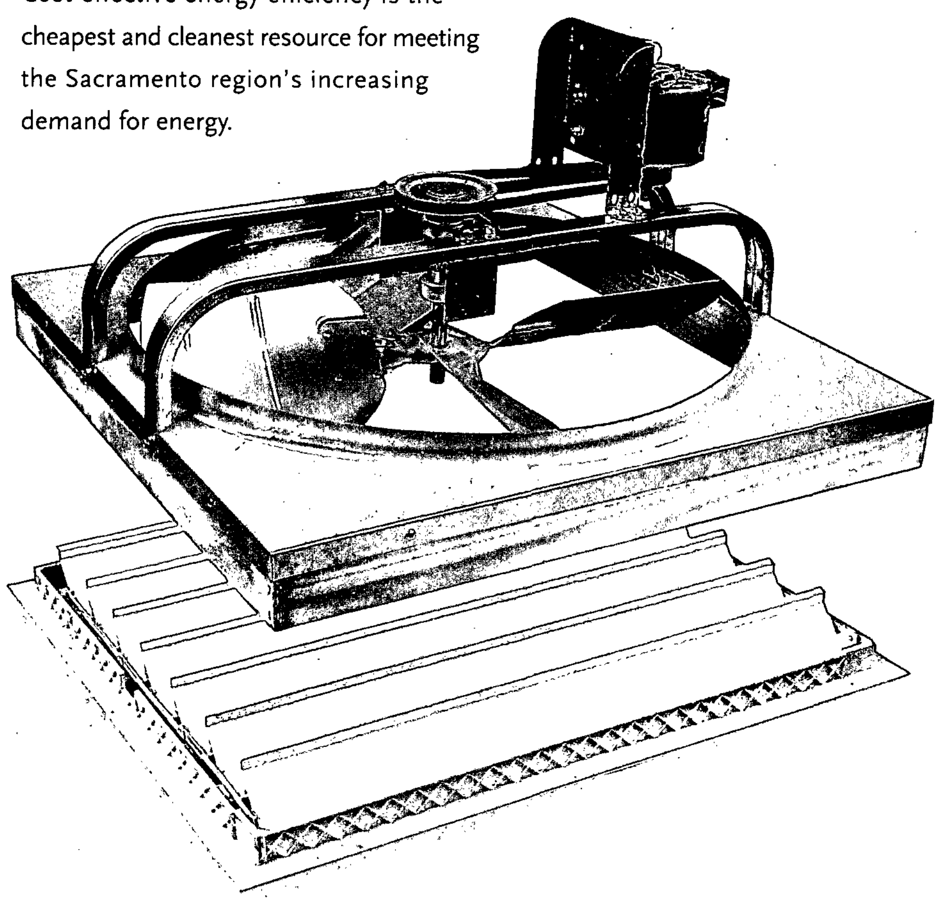
To reach this ambitious target, SMUD is ramping up energy efficiency programs over the next two years. Spending for energy efficiency programs will climb to $34 million in 2008 and $40 million in 2009.

Fortunately, SMUD is on familiar ground here, having invested more than $300 million in energy efficiency since 1994. The payoff is significant – SMUD customers saved more than $550 million during that time frame while making significant contributions to a cleaner environment.

SMUD offers rebates on energy-efficient appliances such as compact fluorescent lamps, clothes washers, air conditioning and heating systems, dishwashers, whole-house fans and photovoltaic systems. SMUD customers have planted more than 430,000 free shade trees, reducing air conditioning costs while improving the region's air quality.

Cost-effective energy efficiency is the cheapest and cleanest resource for meeting the Sacramento region's increasing demand for energy.

A whole-house fan is an excellent way to reduce home cooling costs.



Many Sacramento-area businesses are already doing their part to reduce their energy use and help the environment. SMUD's Community Energy Awards honor commercial customers who share SMUD's environmental philosophy and are taking action.

2007 SMUD Community Award Winners

Many Sacramento-area businesses are already doing their part to reduce their energy use and help the environment. SMUD's Community Energy Awards honor commercial customers who share SMUD's environmental philosophy and are taking action.

The 2007 SMUD Community Energy Award winners all managed their energy usage, lowered their electric bills and reduced the need to generate significant amounts of energy.

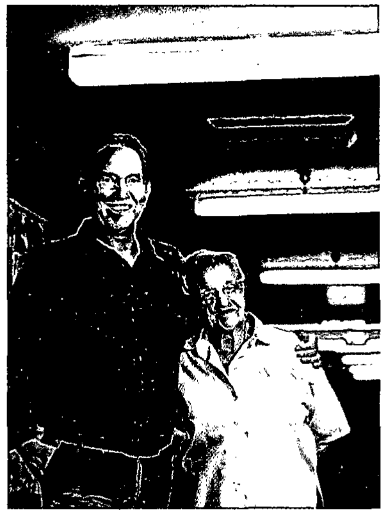
For instance, Mervyn's reduced its energy needs by 130 kilowatts by retrofitting the lighting systems in its Sacramento-area stores. Lowe's experienced similar savings with a lighting retrofit of its stores.

United Stationers implemented a warehouse-wide "intelligent" conveyor system that uses photo eyes, long-range sensors and foot pedals to allow timed operation of all 126 motor and conveyor drives.

RagingWire, an enterprise data center, purchased 216,000 kilowatt-hours of renewable energy through SMUD's Greenergy® program. Aerojet replaced its standard, energy-intensive ultraviolet technology for groundwater extraction and treatment by implementing a new technology known as HiPOx.

The Albert Einstein Residence Center completed a comprehensive lighting retrofit of the facility and replaced inefficient heating and air-conditioning equipment. Les Schwab Tires retrofitted all its stores in the SMUD service area with energy-efficient lighting and occupancy sensors to automatically turn off lights when not in use.

As these businesses have shown, energy efficiency is not only good for the environment – it's good for the bottom line.

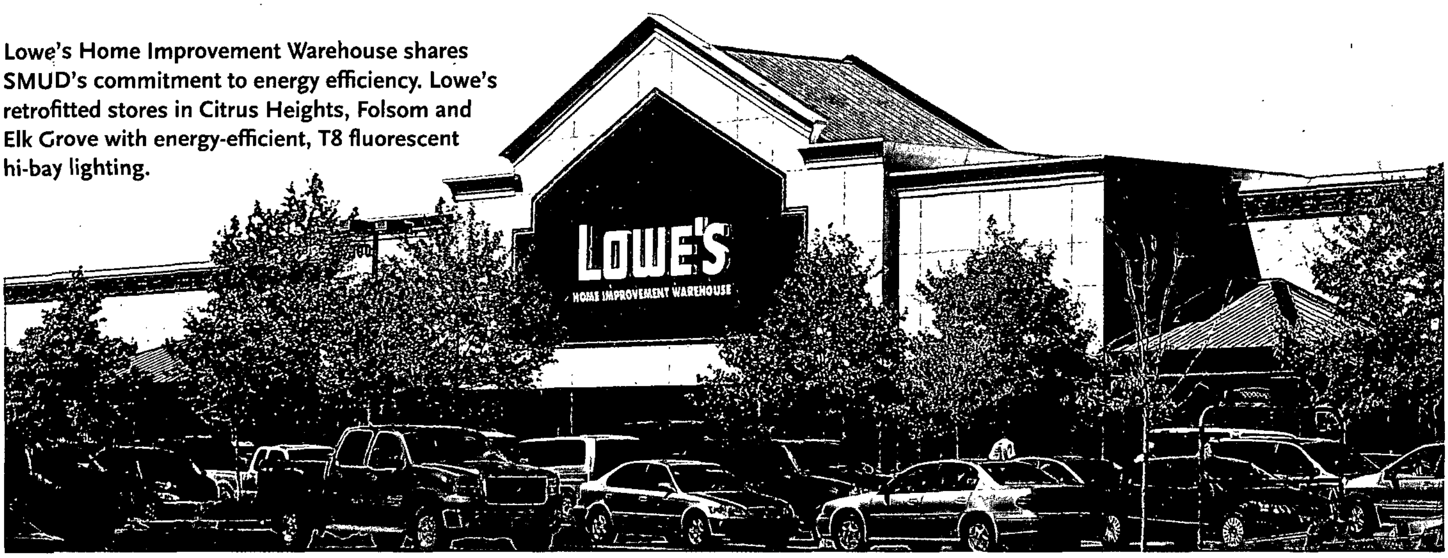


The Albert Einstein Residence Center received a Community Energy Reward for retrofitting its lighting system, among other energy-saving measures.

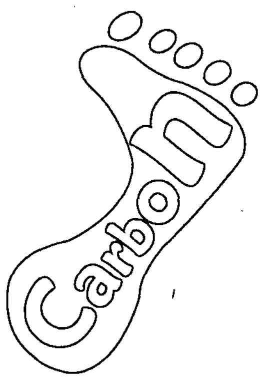
Shining Examples

Les Schwab retrofitted all its tire stores in the SMUD service area with energy-efficient lighting and occupancy sensors to automatically turn off lights when not in use. The change resulted in peak demand savings of 78.3 kilowatts and energy savings of 419,946 kilowatt-hours.

Lowe's Home Improvement Warehouse shares SMUD's commitment to energy efficiency. Lowe's retrofitted stores in Citrus Heights, Folsom and Elk Grove with energy-efficient, T8 fluorescent hi-bay lighting.



While SMUD talks about reducing the region's carbon footprint, it's equally important to walk the talk. Sure enough, customers participating in focus groups often asked, "What's SMUD doing to help the environment?"



Vehicles using alternative fuels are one way in which SMUD conducts its business affairs in an environmentally responsible manner.

The short answer: Quite a bit.

SMUD is committed to obtaining 23 percent of its power from renewable energy sources by 2011. SMUD currently receives about 17 percent of its power from renewable energy sources – not including the clean power it receives from the Upper American River Project.

Nationally, SMUD is recognized as one of the cleanest electric utilities. But while SMUD works to reduce the region's carbon emissions, it's equally important to walk the talk. In fact, customers participating in recent focus groups often asked, "What's SMUD doing to help the environment?"

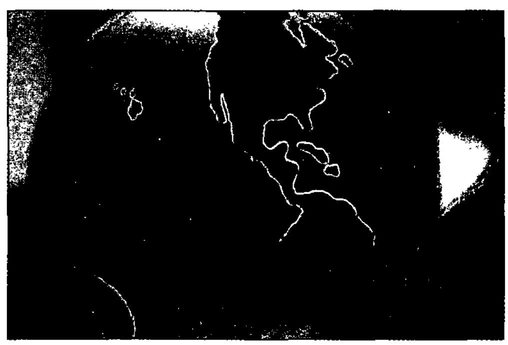
In 2007, SMUD became the first utility in the country to win top honors for Leadership in Energy and Environmental Design. LEED standards were developed by the U.S. Green Building Council to encourage energy efficiency.

SMUD's Customer Service Center incorporates cutting-edge technology. The building was designed to be 35 percent more energy efficient than California's already stringent Title 24 building standards. For instance, water use in the Customer Service Center is nearly 30 percent below code requirements.

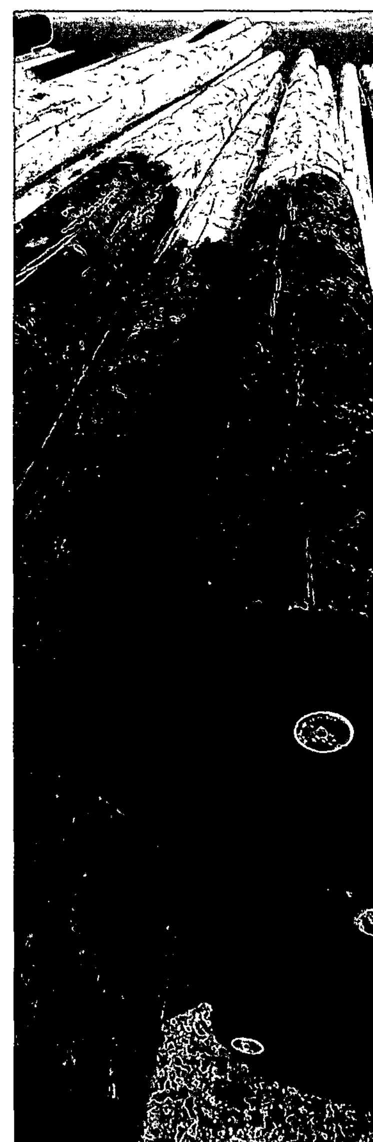
SMUD incorporates a number of earth-friendly practices in its daily operations, from using soy-based oil in distribution transformers to using recycled paper for 95 percent of its printing. Utility poles made of Western Red Cedar are treated at the base end only, reducing the use of chemicals by 20,000 gallons. SMUD daily business practices mirror its green policies.

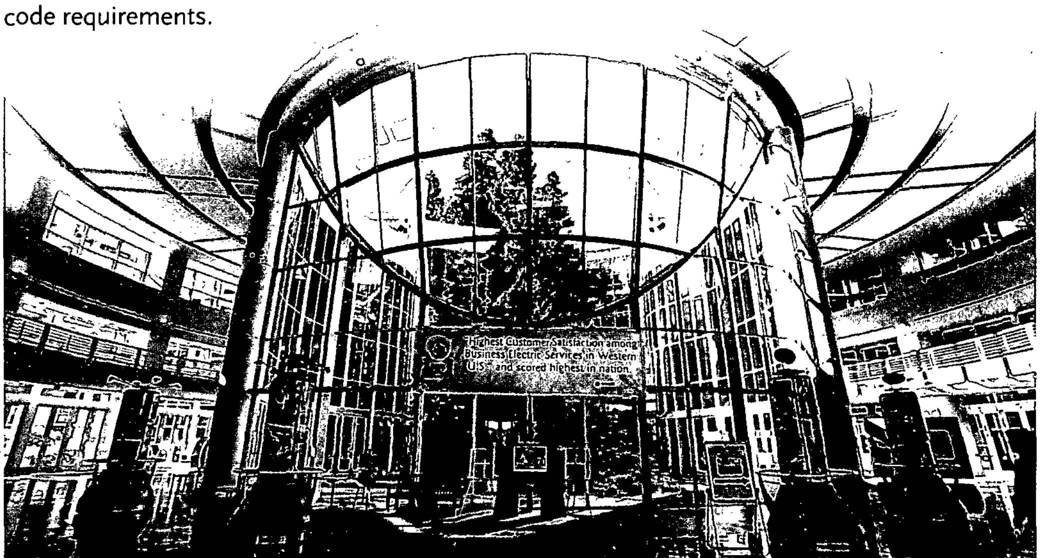
The U.S. Green Building Council developed Leadership in Energy and Environmental Design (LEED) standards to encourage sustainable building design and construction.

SMUD Matches Words with Actions



SMUD's Customer Service Center (below) received platinum designation, the highest LEED rating, for its energy-efficient design. SMUD utility poles made of Western Red Cedar (right) are treated at the base end only, greatly reducing the need for chemical treatment.





SMUD has long encouraged customers to unscrew their incandescent light bulbs and replace them with energy-saving compact fluorescent light bulbs, or CFLs. On a pleasant fall afternoon in the Oak Park neighborhood, SMUD joined students from Sacramento High School in taking its message door to door.

liveGREEN with SMUD

Oak Park CFL Exchange

SMUD has long encouraged customers to unscrew their incandescent light bulbs and replace them with energy-saving compact fluorescent light bulbs, or CFLs. On a Saturday morning in Sacramento's Oak Park neighborhood, SMUD delivered its message.

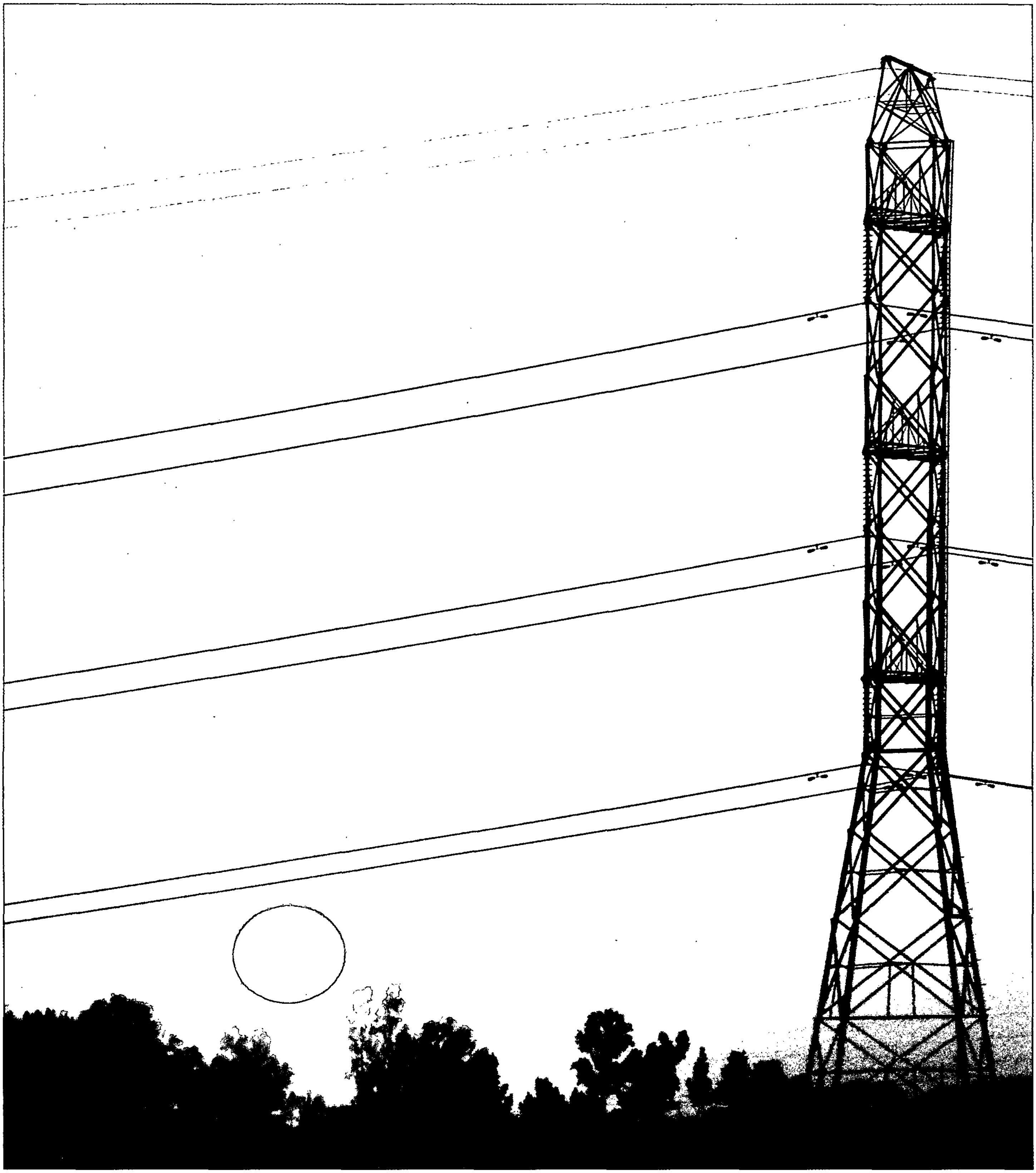
Thirty SMUD volunteers and 100 Sacramento High School students went door to door offering free CFLs to Oak Park residents in exchange for their less-efficient incandescent bulbs. SMUD distributed nearly 1,000 CFLs through the Oak Park exchange.

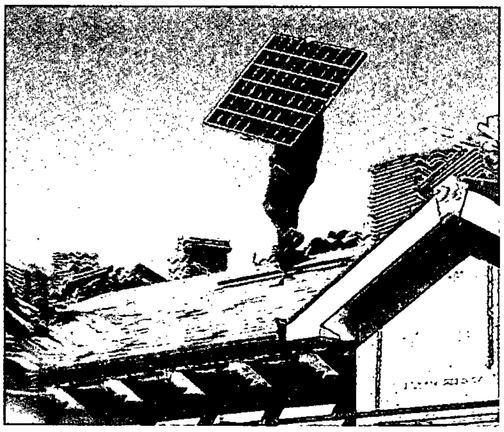
If every American home replaced just one light bulb with an ENERGY STAR-qualified CFL, it would prevent greenhouse gases equivalent to the emissions of more than 800,000 cars. CFLs also last eight to 10 times longer than old-fashioned bulbs.

Each of the participating Sac High students received free CFLs and were educated in the benefits of energy efficiency. In this particular instance, a few small steps for SMUD resulted in energy savings of 30,000 kilowatt-hours.

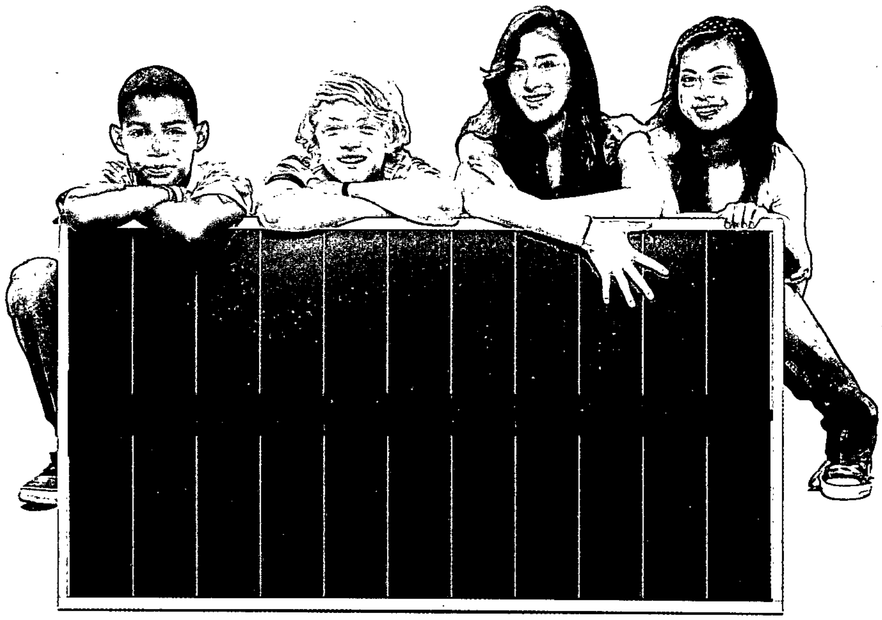
Sacramento High School students joined SMUD volunteers in distributing nearly 1,000 free compact fluorescent light bulbs to Oak Park residents.

In addition to exceeding 10 megawatts in solar capacity for the first time, 2007 was a landmark year for SMUD in terms of tapping into the sun's energy.





Sacramento is a hotbed for rooftop solar installations.



In addition to exceeding 10 megawatts in solar capacity for the first time, 2007 was a landmark year for SMUD in terms of tapping into the sun's energy.

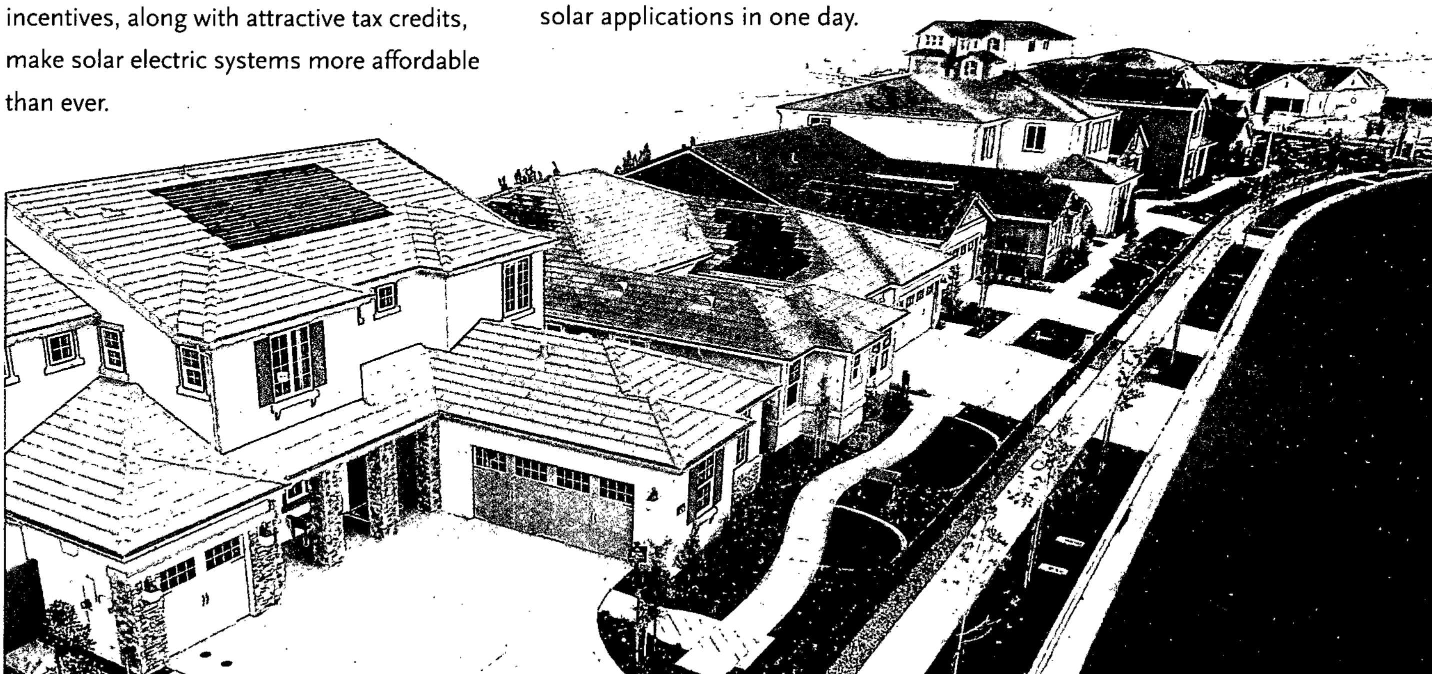
SMUD signed partnerships with nine homebuilders in 2007 to construct more than 2,600 SolarSmart® homes throughout the region. SMUD's partnership with Lennar Homes to build more than 1,200 homes was the largest solar partnership in the United States.

In SolarSmart communities, SMUD provides incentives to buy down the cost of the solar electric systems and provides rebates for energy efficiency upgrades. These rebates and incentives, along with attractive tax credits, make solar electric systems more affordable than ever.

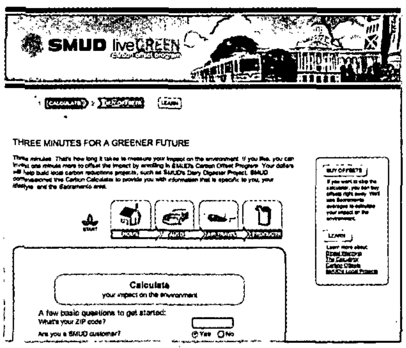
Here Comes the Sun

SMUD also worked with local jurisdictions to make it easier for residential customers to install photovoltaic systems on their homes. Elk Grove became SMUD's first Solar Partner, joined later in the year by the county of Sacramento and the cities of Sacramento, Galt, Folsom, Rancho Cordova and Citrus Heights. The jurisdictions agreed to waive permit fees and review residential solar applications in one day.

SMUD's alliance with Lennar Homes was the largest solar partnership in the United States.



To provide an online gathering place for local environmental groups and environmentally minded individuals, **SMUD launched www.OurGreenCommunity.org. The interactive Web site includes articles and videos, blogs and a carbon calculator.**



OurGreenCommunity.org includes a carbon calculator that helps SMUD customers determine their greenhouse gas emissions and decide whether they want to buy carbon offsets.

Offset Your Emissions

Join SMUD's Carbon Offset Program today and become carbon neutral

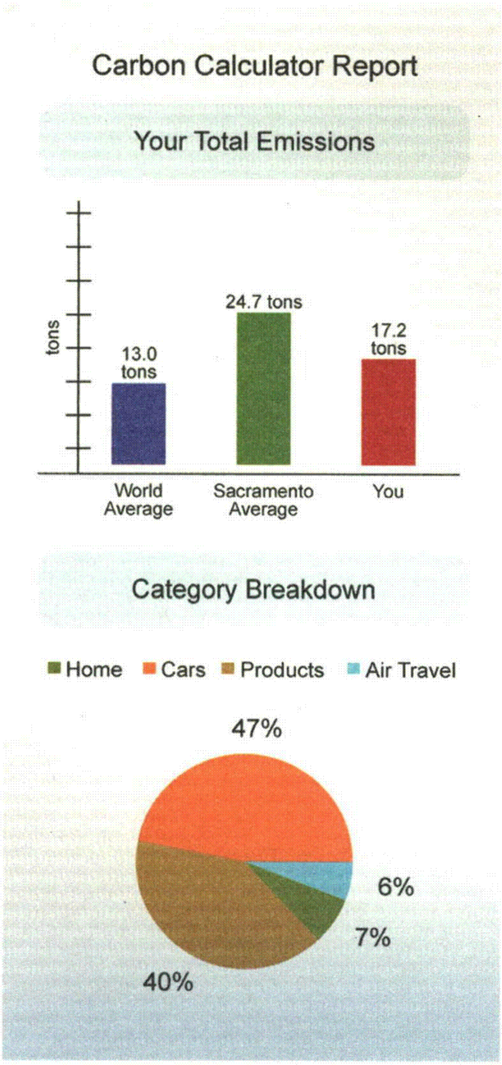
With its carbon calculator, SMUD uses the information customers provide about their energy consumption to estimate how much carbon dioxide (CO_2) and other greenhouse gases they contribute to the atmosphere.

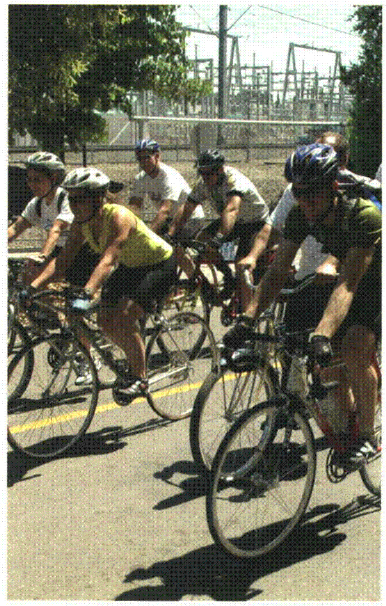
Green is the Online Theme

To provide an online gathering place for local environmental groups and environmentally minded individuals, SMUD launched www.OurGreenCommunity.org. The interactive Web site includes articles and videos, blogs and a carbon calculator.

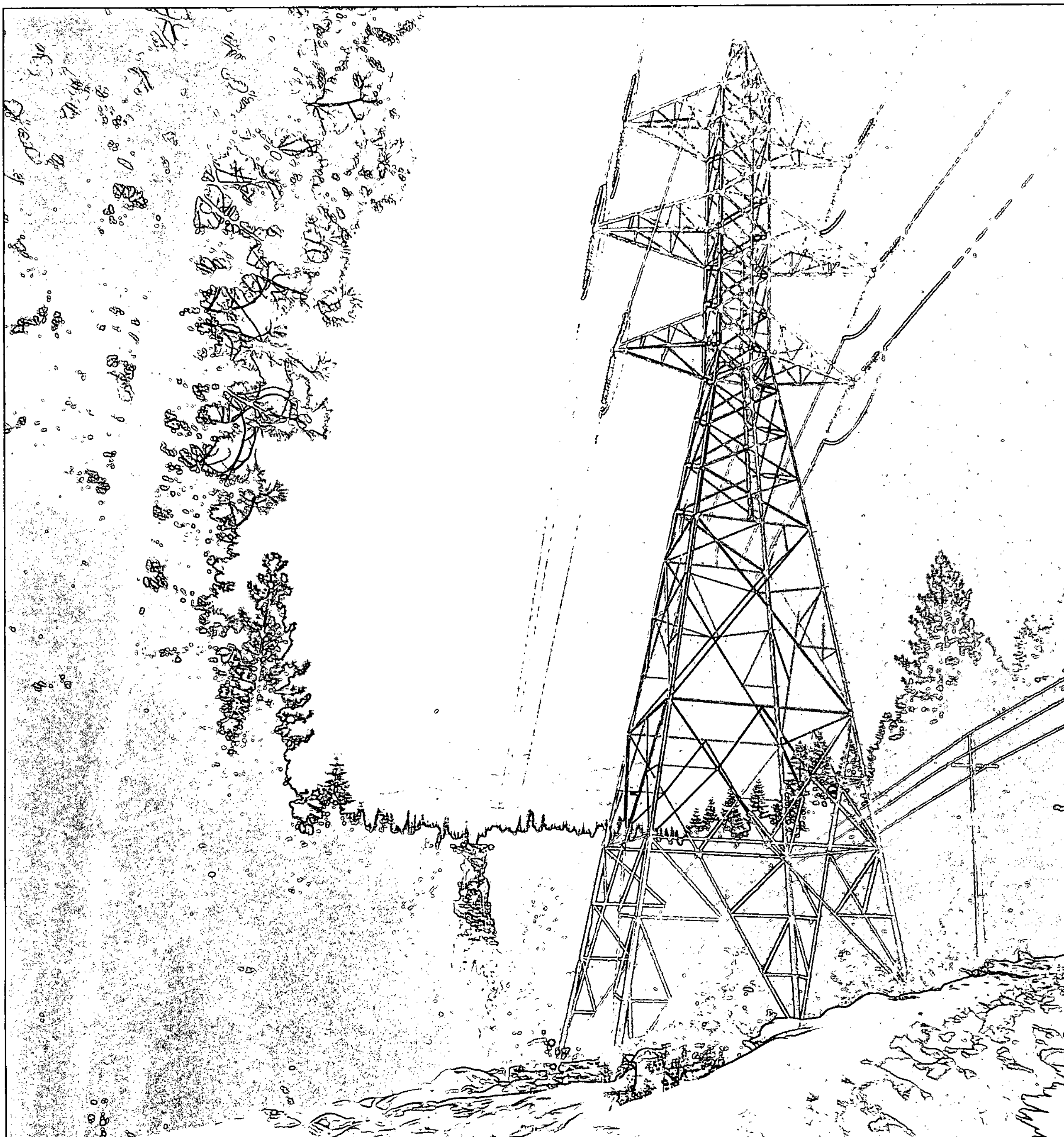
The carbon calculator on OurGreenCommunity.org lets users calculate their "carbon footprint," the sum of all the greenhouse-gas emissions associated with their home energy use, fuel burned in their transportation, and production of their food and other consumer goods. The calculator includes energy-efficiency recommendations. Those without computer access can take a paper survey or get help from SMUD staff to calculate their carbon footprint.

Customers who want to take a step further, or do all they can to compensate for emissions they cannot eliminate, they can enroll in SMUD's Carbon Offset program. Their dollars go to build local emission reduction projects. The cost to offset emissions is $10 per ton of carbon dioxide.





Due to a dry winter, SMUD had to replace lost hydroelectric generation with wholesale power purchases in 2007. Snowfall and spring runoff in the Upper American River Project were well below average.



Due largely to a below-average hydroelectric year and a sharp downturn in the local housing market, SMUD recorded a net loss of $4.6 million in 2007. It marked just the third time in the last 20 years that SMUD posted a net loss.

With $91 million in its rate stabilization fund, SMUD remains on solid financial footing, but steps were taken to rectify the situation. In 2007, the Board of Directors passed a rate increase that took effect Jan. 1, 2008. The 7-percent increase included a solar surcharge that will help SMUD fulfill the California solar energy requirements set forth in Senate Bill 1.

SMUD started to feel the collapse of the housing market and a slowing economy last year. The effects became pronounced in the fourth quarter, when growth in the customer base stalled.

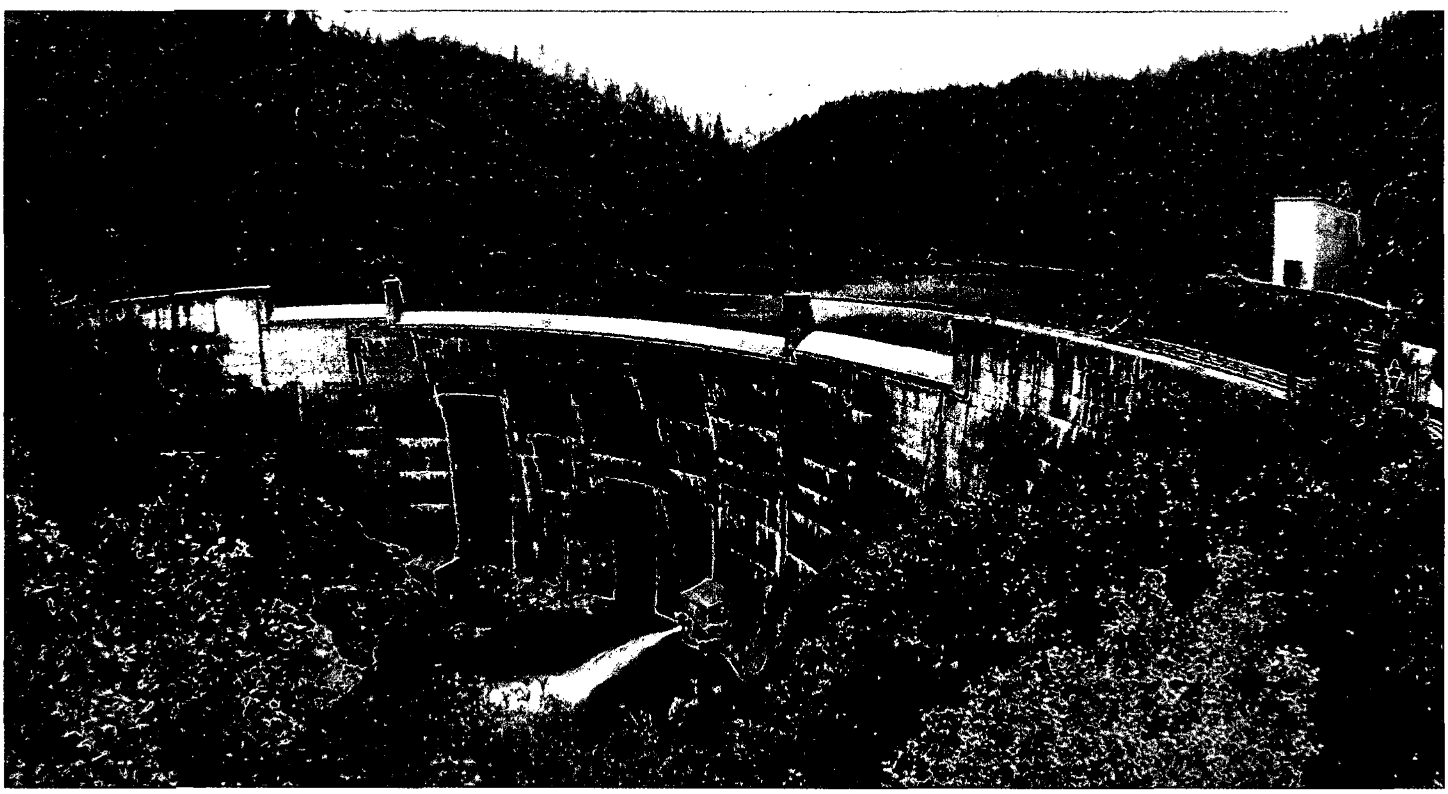
Snowfall and spring runoff in SMUD's Upper American River Project were well below average in the water year that ended Oct. 1. Fresh Pond received 41.8 inches of precipitation, or 73 percent of the historical water-year average. Runoff into SMUD's storage reservoirs was only about 65 percent of the historical average.

The volume of electricity SMUD received from the federal Central Valley Project also declined by about 30 percent due to dry conditions throughout the Sierra. SMUD had to replace the lost hydro generation with wholesale power purchases.

With $91 million in its rate stabilization fund, SMUD remains on solid financial footing.

Challenges Ahead

SMUD started to feel the collapse of the housing market and a slowing economy in 2007. The effects became pronounced in the fourth quarter, when growth in the customer base stalled.



2007 Financial Statements

5 YEAR SUMMARY (UNAUDITED)

Operating Statistics (i)	2007	2006	2005	2004	2003
Customers at year-end	589,599	585,221	577,946	567,176	553,337
KWH Sales (thousands)					
Sales to customers —					
Residential	4,608,170	4,760,391	4,534,276	4,446,117	4,372,111
Commercial, industrial & other	6,209,689	6,038,839	5,951,447	5,790,984	5,547,617
Subtotal	10,817,859	10,799,230	10,485,723	10,237,101	9,919,728
Sales of surplus power	2,427,964	3,964,326	1,496,569	858,234	1,547,595
Total	13,245,823	14,763,556	11,982,292	11,095,335	11,467,323
Revenues (thousands of dollars)					
Sales to customers —					
Residential	$ 493,910	$ 515,025	$ 480,100	$ 442,704	$ 444,713
Commercial, industrial & other	589,922	566,851	557,305	527,828	516,562
Subtotal	1,083,832	1,081,876	1,037,405	970,532	961,275
Sales of surplus power	134,002	191,931	73,475	23,856	62,382
Sales of surplus gas	78,292	112,719	114,313	62,022	65,279
Total (ii)	$ 1,296,126	$ 1,386,526	$ 1,225,193	$ 1,056,410	$ 1,088,936
Average kWh sales per residential customer	8,841	9,202	8,909	8,927	8,998
Average revenue per residential kWh sold (cents)	10.49	10.60	10.41	9.91	10.11
Power supply (thousands of kWh)					
Hydroelectric	1,056,893	2,804,704	2,236,818	1,259,570	1,575,534
Cogeneration	5,886,579	4,775,933	2,196,055	2,417,533	2,292,179
Windpower	117,197	73,887	36,828	41,644	27,376
Photovoltaic	2,235	2,323	2,341	2,201	2,380
Gas turbine	181	7,918	2,225	13,445	2,568
Purchases	6,724,160	7,679,518	7,968,762	7,853,322	8,067,294
Net system peak demand — 1 hour (kW)	3,099,000	3,280,000	2,959,000	2,672,000	2,809,000
Equivalent Full Time Employees at year-end	2,226	2,213	2,279	2,209	2,219
Financial Statistics (thousands of dollars)					
Operating revenues	$ 1,312,083	$ 1,354,427	$ 1,225,193	$ 1,068,727	$ 1,032,867
Operating expenses —					
Purchased and interchanged power	385,021	388,714	463,710	373,362	387,985
Operation and maintenance	666,661	620,002	461,229	398,696	386,423
Depreciation and amortization	133,603	125,937	107,751	99,754	138,881
Decommissioning	31,620	30,894	29,408	29,166	29,708
Total operating expenses	1,216,905	1,165,547	1,062,098	900,978	942,997
Operating income	95,178	188,880	163,095	167,749	89,870
Other income	47,340	47,421	26,591	24,972	29,828
Income before interest charges	142,518	236,301	189,686	192,721	119,698
Interest charges	147,101	128,895	106,414	108,860	119,698
Net increase (decrease) in net assets	$ (4,583)	$ 107,406	$ 83,272	$ 83,861	$ -0-
Funds available for revenue bond debt service	$ 245,604	$ 345,293	$ 310,257	$ 310,739	$ 254,036
Revenue bond debt service	$ 181,706	$ 174,121	$ 160,036	$ 136,929	$ 119,238
Revenue bond debt service coverage ratio	1.35	1.98	1.94	2.27	2.13
Electric utility plant — net	$ 2,882,321	$ 2,734,776	$ 2,662,311	$ 2,493,785	$ 2,239,073
Capitalization					
Long-term debt	$ 3,173,216	$ 2,518,309	$ 2,303,188	$ 2,406,325	$ 2,358,710
Customer's equity	$ 488,411	$ 492,994	$ 385,588	$ 302,316	$ 218,455

i Financial information is consolidated (except the debt service information).

ii Prior to the net deferral/transfer of revenues to/from the Rate Stabilization Fund and deferral of Public Good revenue.

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Independent Auditors' Report

Virchow Krause & company

To the Board of Directors of Sacramento Municipal Utility District, Sacramento, California

We have audited the accompanying consolidated balance sheets of Sacramento Municipal Utility District and its blended component units as of December 31, 2007 and 2006, and the related consolidated statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of Sacramento Municipal Utility District's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sacramento Municipal Utility District and its blended component units at December 31, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 15, the Sacramento Municipal Utility District adopted the provisions of GASB Statement No. 45 — *Accounting and Financial Reporting by Employers for Postemployment benefits other than Pensions (OPEB)* effective January 1, 2007.

The management's discussion and analysis on pages 28 through 35 and the Schedules of Funding Progress are not a required part of the consolidated financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. 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.

Virchow, Krause & Company, LLP

Madison, Wisconsin
February 21, 2008

The following discussion and analysis of the Sacramento Municipal Utility District and its component units (District) financial performance provides an overview of the District's financial activities for the years ended December 31, 2007 and 2006. This discussion and analysis should be read in conjunction with the District's financial statements and accompanying notes, which follow this section.

BACKGROUND

The District was formed by a vote of the electors in 1923, under provisions of the State of California Municipal Utility District Act, and began electric operations in 1947. The District is governed by an elected Board of Directors and has the rights and powers to fix rates and charges for commodities or services furnished, to incur indebtedness and issue bonds or other obligations, and, under certain circumstances, to levy and collect ad valorem property taxes. The District is responsible for the acquisition, generation, transmission, and distribution of electric power to its service area, which includes most of Sacramento County and a small adjoining portion of Placer County.

Setting of Rates

The District's Board of Directors (Board) has autonomous authority to establish the rates charged for all District services. Changes in such rates require formal action, after public hearing, by the Board.

In June 2007, the Board approved an average system rate increase of approximately seven percent that was effective in rates beginning January 1, 2008.

Financial Reporting

The District's accounting records are maintained in accordance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board. The District's accounting records generally follow the Uniform System of Accounts for Public Licensees prescribed by the Federal Energy Regulatory Commission, except as it relates to the accounting for contributions of utility property in aid of construction.

In accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation", the Board has taken various regulatory actions for ratemaking purposes that result in the deferral of expense or revenue recognition. As of December 31, 2007, the District had total regulatory costs for future recovery of $176 million, which is a net decrease of $36 million from 2006. The decrease is due primarily to a decrease in the deferred decommissioning liability due to continued decommissioning progress, a decrease in deferred operation costs for the Transmission Agency of Northern California (TANC), and a decrease for the decommissioning of nuclear enrichment facilities due to the ongoing payment in 2007. These decreases were partially offset by an increase in the U.S. Bureau of Reclamation deferred liability as a result of an increase in the valuation of the liability. The District also had regulatory credits of $392 million as of December 31, 2007, which is a net increase of $57 million from 2006. The increase is primarily due to the change in value of derivative financial instruments, an increase in the deferral of gains from contribution in aid of construction and deferred estimated gains from precipitation hedges reflecting low precipitation from October 1, 2007 through December 31, 2007. These increases have been partially offset by the reduction of the Rate Stabilization Fund as a result of transfers to revenue to cover low Western Area Power Administration energy deliveries and costs related to energy efficiency and other Board-approved programs. The regulatory costs and regulatory credits will be recognized in the consolidated Statement of Revenues, Expenses and Changes in Net Assets in future periods as determined by the Board for ratemaking purposes.

Using This Financial Report

This financial annual report consists of management's discussion and analysis and the consolidated financial statements, including notes to the consolidated financial statements. The financial annual report reflects the activities of the District primarily funded through the sale of energy, transmission, and distribution services to its customer-owners.

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

The consolidated financial statements provide both short-term and long-term information about the District's financial status. The consolidated Balance Sheets include all of the District's assets and liabilities, using the accrual method of accounting, as well as an indication about which assets can be utilized for general purposes, and which assets are restricted as a result of bond covenants, Board action and other commitments. The consolidated Balance Sheets provide information about the nature and amount of resources and obligations at a specific point in time. The consolidated Statements of Revenues, Expenses and Changes in Net Assets report all of the District's revenues and expenses during the periods indicated. The consolidated Statements of Cash Flows report the cash provided and used by operating activities, as well as other cash sources such as investment income, debt financing, and other cash uses such as payments for bond principal and capital additions and betterments.

FINANCIAL HIGHLIGHTS

Condensed Consolidated Balance Sheets
(millions)

	December 31, 2007	December 31, 2006	December 31, 2005
Assets			
Electric Utility Plant — net	$ 2,882	$ 2,735	$ 2,662
Restricted and Designated Assets	273	286	243
Current Assets	734	781	950
Noncurrent Assets and Deferred Charges	1,077	331	577
	$ 4,966	$ 4,133	$ 4,432
Liabilities and Net Assets			
Long-Term Debt — net	$ 3,173	$ 2,518	$ 2,303
Current Liabilities and Deferred Credits	724	542	877
Noncurrent Liabilities and Deferred Credits	580	580	866
Net Assets:			
Invested in capital, net of related debt	321	252	200
Restricted	95	89	53
Unrestricted	73	152	133
	$ 4,966	$ 4,133	$ 4,432

ASSETS

Utility Plant — net

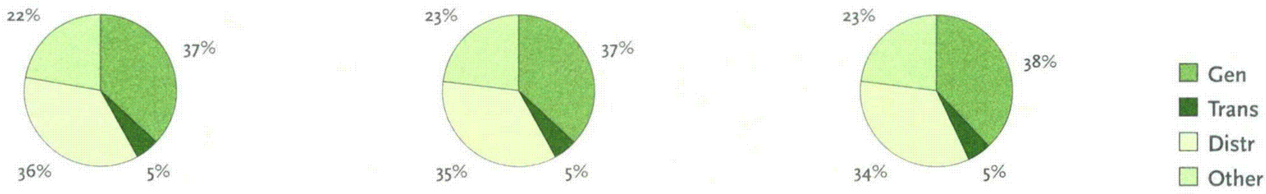
2007 Compared to 2006 The District has invested approximately $2.9 billion in utility plant assets and construction work in progress net of accumulated depreciation at December 31, 2007. Net utility plant makes up about 58 percent of the District's assets,approximately 8 percent less than the previous year. The percentage reduction was primarily due to the addition of a prepaid gas supply contract of $722 million in the Noncurrent Assets and Deferred Charges category. During 2007, the District capitalized approximately $287 million of additions to utility plant, including additions to construction work in progress in the District's consolidated financial statements. This was a result of routine capital additions for generation, transmission, distribution, and general plant.

2006 Compared to 2005 The District has invested approximately $2.7 billion in utility plant assets and construction work in progress net of accumulated depreciation at December 31, 2006. Net utility plant makes up about 66 percent of the District's assets, approximately 6 percent more than the previous year. During 2006, the District capitalized approximately $203 million of additions to utility plant, including additions to construction work in progress in the District's consolidated financial statements. This was a result of routine capital additions for generation, transmission, distribution, and general plant.

The District entered into a contract with Fru-Con Construction Corporation (Fru-Con) to construct the Cosumnes Power Plant project. Unable to resolve the disputes over costs and delays to the satisfaction of the District, the contract was terminated in February 2005. The District is currently in litigation with Fru-Con to resolve these disputes. The District assumed the construction management responsibilities for the completion of the Cosumnes Power Plant project. See Note 6 for additional details.

The following charts show the breakdown of net utility plant by major plant category — Generation (Gen), Transmission (Trans), Distribution (Distr), and Other:

December 31, 2007 **December 31, 2006** **December 31, 2005**



Restricted and Designated Assets

2007 Compared to 2006 The District's level of Restricted and Designated Assets decreased by $13 million during 2007 primarily due to a reduction of the Nuclear Decommissioning Trust Fund reflecting continued progress on decommissioning the Rancho Seco nuclear power plant, a decrease in the Rate Stabilization Fund as a result of recognizing $16 million in current year revenues, and an increase in the current portion of Restricted and Designated Assets. These decreases were partially offset by an increase of Revenue Bond Reserve funds as a result of the issuance of debt by the Northern California Gas Authority No. 1 (NCGA), a component unit of the District.

2006 Compared to 2005 The District's level of Restricted and Designated Assets increased by $43 million during 2006 primarily due to an increase in Reserve Bond funds as a result of the Sacramento Municipal Utility District Financing Authority (SFA) financing, deposits into the Rate Stabilization Fund, and an increased level of collateral for securities lending, partially offset by an increase in the current portion of Restricted and Designated Assets.

Current Assets

2007 Compared to 2006 Current Assets decreased by $47 million in 2007 due to a decrease in Unrestricted Cash, Restricted and Designated Investments, receivables for both retail and wholesale customers, Regulatory Costs to be recovered within one year, and Derivative Financial Instruments. These decreases were partially offset by an increase in Restricted and Designated Cash, Conservation Loans due within one year, Accrued Interest and Other, and the current portion of Prepaid Gas.

2006 Compared to 2005 Current Assets decreased by $169 million in 2006 due to a decrease in Unrestricted Cash, a decrease in wholesale receivables, a decrease in the deferred precipitation hedge liability, and a decrease in the value of the current portion of Derivative Financial Instruments mainly due to more energy contracts being excluded as normal purchases and sales contracts and lower gas prices. These decreases were partially offset by an increase in Restricted and Designated Cash and Cash Equivalents, an increase in Restricted and Designated Investments, an increase in retail receivables, and an increase in Materials and Supplies.

Noncurrent Assets and Deferred Charges

2007 Compared to 2006 Total Noncurrent Assets and Deferred Charges increased by $746 million. This reflects the prepayment of a 20-year natural gas supply agreement with the Morgan Stanley Capital Group, an increase in the value of Derivative Financial Instruments, and an increase in Conservation Loans made to customers. The increase was partially offset by the continued progress of decommissioning the Rancho Seco nuclear power plant.

2006 Compared to 2005 Total Noncurrent Assets and Deferred Charges decreased by $246 million. This reflects the exclusion of more energy contracts as normal purchases and sales contracts and lower gas prices, the continued decommissioning of the Rancho Seco nuclear power plant, and the assignment of a portion of the liability to the Bureau.

LIABILITIES

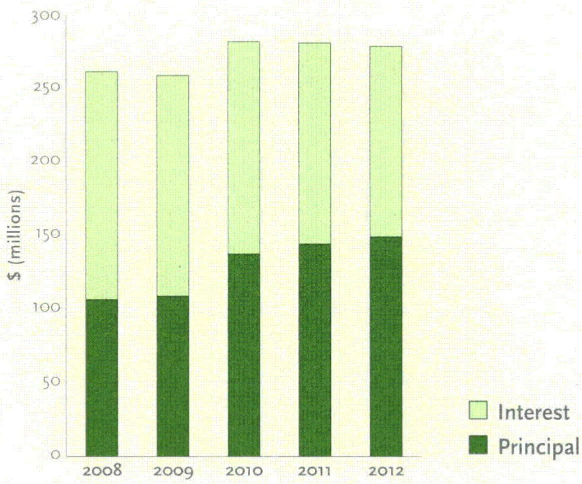
Long-Term Debt

2007 Compared to 2006 In May 2007, the NCGA, a component unit of the District, issued $89 million of fixed rate Gas Project Revenue Bonds and $668 million of index rate Gas Project Revenue Bonds. The proceeds were used to fund the prepayment of a 20-year natural gas supply agreement.

2006 Compared to 2005 In January 2006, the SFA, a component unit of the District, issued $300 million of 2006 Series SFA Cosumnes Project Revenue Bonds. In July 2006, the Central Valley Financing Authority (CVFA), a component unit of the District, redeemed $1.9 million of CVFA Bonds reducing future debt service.

The following table shows the District's future debt service requirements through 2012 as of December 31, 2007:

Debt Service Requirements



As of December 31, 2007, the District had an underlying rating of "A" from both Standard & Poor's and Fitch, and a higher rating of "A1" from Moody's. Most of the District's bonds are insured and are therefore rated by the rating agencies at a level similar to that of the insurers.

Current Liabilities and Deferred Credits

2007 Compared to 2006 Current Liabilities and Deferred Credits increased by approximately $182 million during 2007. During 2007, the District issued $150 million of Commercial Paper Notes to finance or reimburse capital expenditures. Other increases were in Accounts Payable including $13 million for the unfunded Other Post-Employment Benefit liability; Long-Term Debt due within one year and accrued interest due to the issuance of debt by NCGA; the current portion of Regulatory Credits mainly due to the deferred estimate of the precipitation hedge liability; and Customer Deposits and Other. The increases were partially offset by lower Accrued Decommissioning and the current portion of Derivative Financial Instruments.

2006 Compared to 2005 Current Liabilities and Deferred Credits decreased by approximately $335 million during 2006. In 2005, the District had issued $200 million of Commercial Paper Notes primarily to provide short-term financing for the construction of the Cosumnes Power Plant. During 2006, the District sold the Cosumnes Power Plant to SFA and redeemed the Notes with a portion of the proceeds. Purchased Power payable decreased significantly from 2005 reflecting lower power costs. The current portion of Credit Support Collateral for energy purchases decreased to $10 million. Additionally, the current portion of Regulatory Credits decreased as a result of excluding more energy contracts as normal purchases and sales contracts.

Noncurrent Liabilities and Deferred Credits

2007 Compared to 2006 Noncurrent Liabilities and Deferred Credits remained about the same as in 2006. Regulatory Credits increased due to increased Contributions In Aid of Construction, the increased value of Derivative Financial Instruments reflecting increased natural gas values, partially offset by the reduction of the Rate Stabilization Fund. The increases in Noncurrent Liabilities and Deferred Credits were offset by a decrease in the Accrued Decommissioning liability as the District continues with decommissioning of the Rancho Seco nuclear power plant.

2006 Compared to 2005 Noncurrent Liabilities and Deferred Credits decreased by $286 million as a result of excluding more energy contracts as normal purchases and sales contracts, a decrease in the non-current portion of Credit Support Collateral for energy purchases, and a decrease in the decommissioning liability as the District continues with decommissioning of the Rancho Seco nuclear power plant.

Condensed Statement of Consolidated Revenues, Expenses and Changes in Net Assets
(millions)

	December 31,		
	2007	2006	2005
Operating revenues	$ 1,312	$ 1,354	$ 1,225
Operating expenses	(1,217)	(1,165)	(1,062)
Operating income	95	189	163
Interest and other income	47	47	26
Interest charges	(147)	(129)	(106)
Increase/(decrease) in net assets	$ (5)	$ 107	$ 83

CHANGES IN NET ASSETS

Operating Revenues

2007 Compared to 2006 Operating Revenues were $1,312 million in 2007, a decrease from 2006 of $42 million. Sales to retail customers were $1,071 million in 2007, a decrease of $13 million as compared to 2006 sales. The District sold 0.2 percent more energy to its retail customers, which grew from 585,221 customers in 2006 to 589,599 customers in 2007, at an average revenue per kilowatt hour that decreased by 1.4 percent. The District transferred $16 million from the Rate Stabilization Fund as compared to a transfer to the Rate Stabilization Fund of $32 million in 2006.

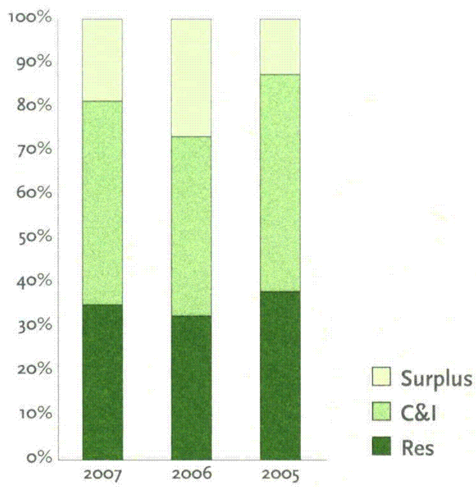
Wholesale revenues are comprised of both surplus energy and gas sales. In 2007, surplus gas sales were $78 million as compared to $113 million in 2006. The amount of surplus gas sold was lower, although at slightly higher average prices. Surplus energy sales in 2007 were $58 million lower than in 2006. The decrease is due to lower volume (39 percent) although at higher average prices (11.7 percent) than in 2006. Lower surplus energy sales are a result of a number of factors, including lower hydro generation and the timing of hydro generation for reservoir management.

2006 Compared to 2005 Operating Revenues were $1,354 million in 2006, an increase from 2005 of $129 million even though $32 million was transferred to the Rate Stabilization Fund in 2006 versus no transfer to or from the Rate Stabilization Fund in 2005. Sales to retail customers were $1,084 million in 2006, an increase of $56 million over 2005 sales. The District sold 3.0 percent more energy to its retail customers, which grew from 577,946 customers in 2005 to 585,221 customers in 2006, at an average revenue per kilowatt hour that increased by 2.4 percent, reflecting a full year of the April 2005 rate increase.

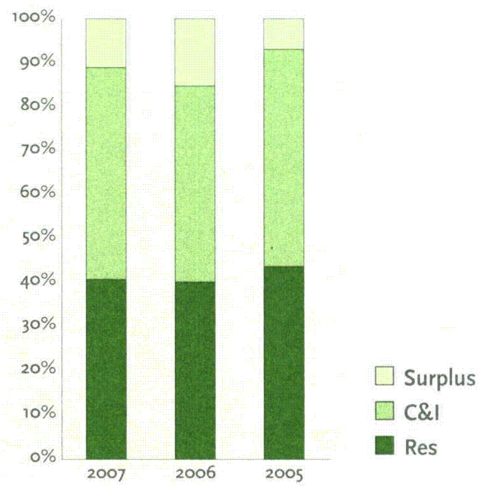
Wholesale revenues are comprised of both surplus energy and gas sales. In 2006, surplus gas sales were $113 million as compared to $114 million in 2005. The amount of surplus gas sold was higher, although at significantly lower average prices. Surplus energy sales in 2006 were $118 million higher than in 2005. The increase is due to higher volume (160 percent) and slightly higher average prices (0.6 percent) than in 2005. Higher surplus energy sales are a result of a number of factors, including higher hydro generation and the timing of hydro generation for reservoir management.

The following charts show the percentage of megawatt hour (MWh) sales and sales revenue in 2007, 2006, and 2005 by surplus energy sales (Surplus), commercial and industrial (C&I), and residential (Res) customers:

MWh Sales



Sales Revenues



Operating Expenses

2007 Compared to 2006 Operating Expenses were $1,217 million in 2007 as compared to $1,165 million in 2006. The District's Purchased Power expense was $4 million lower in 2007 than in 2006. The District spent $10 million more for power purchases in 2007 mainly due to higher market prices, partially offset by less energy purchased as compared to 2006. Approximately 12.4 percent less energy was purchased in 2007 at average prices that were 13.1 percent higher than in 2006. The District reduced Purchased Power expense by $8 million for a settlement from the Automated Power exchange (APX) related to the California Market refund case and $1 million for precipitation hedge receipts. In 2007, fuel costs for generation, a component of Production Costs, were approximately $234 million, or $52 million higher than 2006. More fuel was used in 2007 (7.5 million decatherms), primarily due to a full year of production at the Cosumnes Power Plant and higher generation production for CVFA and SPA. Average fuel prices were 7.5 percent higher in 2007 as compared to 2006.

Transmission and Distribution operations expense was $5 million higher in 2007 as compared to 2006 due to increased costs for TANC transmission as a result of TANC implementing an Open Access Transmission Tariff for its members and California Independent System Operator transmission charges.

The District's expenses for Administrative, General, and Customer were $10 million higher in 2007 due to the expense for the District's Other Post-Employment Benefits unfunded accrued liability, improvements to customer service, and a higher provision for uncollectible conservation loans to customers. These increases were partially offset by lower litigation expenses related to the contract dispute with Fru-Con.

Public Good expenses increased during 2007 as a result of more energy efficiency expenditures and customer incentive payments.

Depreciation expense increased due to a change in the remaining service life for meters as the District transitions to advanced metering technology. Additionally, the service life for certain steam turbine assets at SFA has been reduced to more closely match the overhaul schedule and useful lives of the assets.

In 2007, power supply costs made up approximately 62 percent of total Operating Expenses as compared to 64 percent for 2006.

2006 Compared to 2005 Operating Expenses were $1,165 million in 2006 as compared to $1,062 million in 2005. The District's Purchased Power expense was $75 million lower in 2006 than in 2005. The District spent $87 million less for power purchases in 2006 mainly due to lower market prices and less energy purchased as compared to 2005. The District also reduced Purchased Power expense by $17 million for a judgment in the Scheduling Coordinator Service (SCS) dispute with PG&E. This was partially offset by an increase to expense of $28 million for precipitation hedge payments in 2006 as a result of the excellent hydro conditions. Approximately 4.6 percent less energy was purchased in 2006 at average prices that were 12.1 percent lower than in 2005. In 2006, fuel costs for generation, a component of production costs, were approximately $182 million, or $104 million higher than 2005. More fuel was used in 2006 (18.6 million decatherms), primarily due to the addition of the Cosumnes Power Plant, at average prices that were 19.0 percent higher than in 2005.

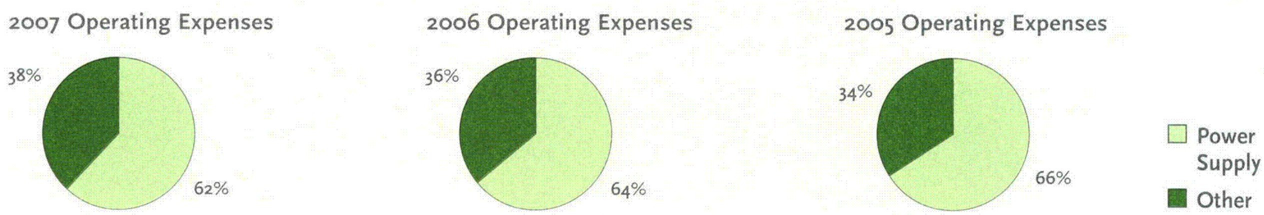
Transmission and Distribution operations expense was $3 million higher in 2006 as compared to 2005 due to higher transmission costs relating to the District performing its own control area and scheduling coordinator functions.

The District had higher expenses for Administrative, General, and Other due to litigation expenses related to the contract disputes with Fru-Con, higher costs due to improvements to customer service, and higher expenditures for Public Good activities, primarily for energy efficiency.

Depreciation expense increased due to the completion of the Cosumnes Power Plant and additions to Plant In Service, primarily for general and distribution plant.

In 2006, power supply costs made up approximately 64 percent of total Operating Expenses as compared to 66 percent for 2005.

The following charts compare the relative cost of Purchased Power, Production expenses, and depletion of the Rosa gas field (power supply costs) to all other Operating Expenses in 2007, 2006, and 2005:



Interest and Other Income

2007 Compared to 2006 Interest and Other Income was approximately the same in 2007 as compared to 2006. Revenues were lower in 2007 due to lower Interest Income, lower grant revenues, and because 2006 revenues included the one-time sale of water rights. This was offset by lower expenses in 2007 because 2006 expenses included the write-off of deferred annexation costs.

2006 Compared to 2005 Interest and Other Income was higher by $21 million in 2006 as compared to 2005. Interest Income was higher due to higher cash balances and higher interest rates in 2006 as compared to 2005, and interest on the SCS tariff settlement in 2006. Other Income was approximately the same in 2006 as in 2005.

Interest Charges

2007 Compared to 2006 Interest Charges in 2007 were $18 million higher than in 2006, which is due primarily to higher Interest on Debt as a result of the NCGA financing for the prepayment of the natural gas supply agreement.

2006 Compared to 2005 Interest Charges in 2006 were $23 million higher than in 2005, which is due primarily to higher Allowance for Funds Used During Construction in 2005 as a result of the progress on the Cosumnes Power Plant project and by higher Interest on Debt as a result of the SFA financing for the Cosumnes Power Plant.

CONSOLIDATED BALANCE SHEETS

Assets	December 31, 2007	December 31, 2006
	(thousands of dollars)	
Electric Utility Plant		
Plant in service	$ 4,002,026	$ 3,774,843
Less accumulated depreciation and depletion	(1,369,030)	(1,264,646)
Plant in service — net	2,632,996	2,510,197
Construction work in progress	249,325	224,579
Total electric utility plant — net	2,882,321	2,734,776
Restricted and Designated Assets		
Revenue bond, debt service and construction reserves	243,347	231,943
Nuclear decommissioning trust fund	69,865	82,315
Rate stabilization fund	91,143	107,100
Securities lending collateral	75,284	76,086
Other funds	803	1,181
Less current portion	(207,741)	(213,065)
Total restricted and designated assets	272,701	285,560
Current Assets		
Unrestricted cash and cash equivalents	169,922	202,944
Restricted and designated cash and cash equivalents	129,803	103,118
Unrestricted investments	-0-	11,792
Restricted and designated investments	77,938	109,947
Receivables — net:		
Retail customers	137,622	142,178
Wholesale	40,021	41,799
Conservation loans due within one year, accrued interest and other	39,076	23,204
Regulatory costs to be recovered within one year	39,464	57,763
Derivative financial instruments maturing within one year	22,870	35,503
Materials and supplies	44,110	40,983
Prepaid Gas	22,220	-0-
Prepayments	10,952	12,155
Total current assets	733,998	781,386
Noncurrent Assets and Deferred Charges		
Regulatory costs for future recovery	136,762	154,134
Prepaid Gas	721,806	-0-
Advance capacity payments	31,548	36,467
Derivative financial instruments	88,054	48,126
Unamortized debt issuance costs	35,671	33,231
Conservation loans	52,615	45,541
Preliminary project studies and other	10,265	13,444
Total noncurrent assets and deferred charges	1,076,721	330,943
Total assets	$ 4,965,741	$ 4,132,665

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

CONSOLIDATED BALANCE SHEETS

Liabilities	December 31, 2007	December 31, 2006
	(thousands of dollars)	
Long-Term Debt — net	$ 3,173,216	$ 2,518,309
Current Liabilities and Deferred Credits		
Commercial paper notes	150,000	-0-
Accounts payable	112,652	88,875
Purchased power payable	73,022	70,562
Credit support collateral obligation	9,650	9,650
Long-term debt due within one year	106,365	98,080
Accrued decommissioning	42,292	54,839
Accrued interest	52,118	43,082
Accrued salaries and compensated absences	29,111	28,836
Derivative financial instruments maturing within one year	10,344	25,725
Regulatory credits to be recognized within one year	31,037	18,879
Securities lending collateral obligation	75,284	76,086
Customer deposits and other	32,198	27,364
Total current liabilities and deferred credits	724,073	541,978
Noncurrent Liabilities and Deferred Credits		
Accrued decommissioning	155,135	197,939
Derivative financial instruments	18,202	22,054
Regulatory credits	360,986	316,198
Credit support collateral obligation	22,500	18,100
Due to affiliated entity	6,571	8,856
Due to U.S. Bureau of Reclamation	6,200	5,790
Self insurance, deferred credits and other	10,447	10,447
Total noncurrent liabilities and deferred credits	580,041	579,384
Total liabilities	4,477,330	3,639,671
Net Assets		
Invested in capital assets, net of related debt	320,700	251,988
Restricted	94,516	89,119
Unrestricted	73,195	151,887
Total net assets	488,411	492,994
Commitments and Contingencies (Notes 17 and 18)		
Total liabilities and net assets	$ 4,965,741	$ 4,132,665

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

Consolidated Statements of Revenues, Expenses and Changes in Net Assets

	Year Ended December 31, 2007	2006
	(thousands of dollars)	
Operating Revenues		
Residential	$ 493,910	$ 515,025
Commercial and industrial	580,489	572,018
Street lighting and other	9,433	8,611
Wholesale	212,294	304,651
Test Power	-0-	(13,778)
Rate stabilization fund transfers	15,957	(32,100)
Total operating revenues	1,312,083	1,354,427
Operating Expenses		
Operations:		
Purchased power	385,021	388,714
Production	364,467	346,586
Transmission and distribution	50,880	45,424
Administrative, general and customer	135,639	125,498
Public good	37,419	29,009
Maintenance	68,805	65,118
Depreciation	132,387	124,745
Depletion	9,451	8,367
Decommissioning	31,620	30,894
Regulatory deferrals collected in rates	1,216	1,192
Total operating expenses	1,216,905	1,165,547
Operating Income	95,178	188,880
Nonoperating Revenues and Expenses		
Other revenues		
Interest income	41,064	42,773
Other income — net	6,276	4,648
Total other revenues	47,340	47,421
Interest charges		
Interest on debt	151,650	132,198
Allowance for funds used during construction	(4,549)	(3,303)
Total interest charges	147,101	128,895
Increase (decrease) in Net Assets	(4,583)	107,406
Net Assets — Beginning of Year	492,994	385,588
Net Assets — End of Year	$ 488,411	$ 492,994

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2007	2006
	(thousands of dollars)	
Cash Flows from Operating Activities		
Receipts from retail customers	$ 1,081,945	$ 1,075,824
Receipts from surplus power sales	137,002	196,271
Receipts from surplus gas sales	78,384	120,451
Receipts from federal and state grants	598	2,648
Receipts from steam sales	9,429	9,427
Other receipts	180	1,286
Repayment/receipts for credit support collateral, net	4,400	(120,850)
Issuance/repayment of conservation loans, net	(9,733)	(9,218)
Payments to employees — payroll and other	(218,084)	(206,564)
Payments for wholesale power	(378,507)	(369,869)
Payments for gas purchases	(304,372)	(285,486)
Payments to vendors/others	(121,064)	(116,182)
Payments/receipts for weather hedge/insurance	1,181	(26,879)
Payments for decommissioning	(56,189)	(35,987)
Net cash provided by operating activities	225,170	234,872
Cash Flows from Investing Activities		
Sales and maturities of securities	363,471	337,853
Purchases of securities	(274,077)	(428,729)
Interest and dividends received	40,617	41,007
Securities lending collateral — net	(802)	9,950
Net cash provided by (used in) investing activities	129,209	(39,919)
Cash Flows from Capital and Related Financing Activities		
Construction expenditures	(267,443)	(236,178)
Contributions in aid of construction	24,421	23,706
Net proceeds from bond issues	754,198	306,482
Repayment and defeasance of debt	(98,080)	(84,240)
Prepaid gas supply expenditures	(754,107)	-0-
Issuance of commercial paper	150,000	-0-
Repayment of commercial paper	-0-	(200,000)
Interest on debt	(137,602)	(120,787)
Net cash used in capital and related financing activities	(328,613)	(311,017)
Net increase (decrease) in cash and cash equivalents	25,766	(116,064)
Cash and cash equivalents at the beginning of the year	354,024	470,088
Cash and cash equivalents at the end of the year	$ 379,790	$ 354,024
Cash and cash equivalents included in:		
Unrestricted cash and cash equivalents	$ 169,922	$ 202,944
Restricted and designated cash and cash equivalents	129,803	103,118
Revenue bond, debt service and construction reserves (a component of the total of $243,347 and $231,943 at December 31, 2007 and 2006, respectively)	80,065	47,962
Cash and cash equivalents at the end of the year	$ 379,790	$ 354,024

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

SUPPLEMENTAL CASH FLOW INFORMATION

A reconciliation of the consolidated statements of cash flows operating activities to operating income is as follows:

	Year Ended December 31, 2007	2006
	(thousands of dollars)	
Operating income	$ 95,178	$ 188,880
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	132,387	124,745
Depletion	9,451	8,367
Regulatory deferrals collected in rates, including decommissioning	32,836	32,086
Amortization of advance capacity & other	4,991	4,993
Revenue (recognized from) deferred to regulatory credits	(17,207)	33,685
Test power revenue capitalized	-0-	13,778
Federal and State grants revenue	598	2,648
Other	(2,649)	(1,191)
Changes in operating assets and liabilities:		
Customer and wholesale receivables	8,662	3,392
Conservation loans	(9,733)	(9,218)
Other assets	8,503	(7,223)
Payables and accruals	18,342	(124,083)
Decommissioning	(56,189)	(35,987)
Net cash provided by operating activities	$ 225,170	$ 234,872

The supplemental disclosure of noncash financing and investing activities is as follows:

	Year Ended December 31, 2007	2006
	(thousands of dollars)	
Loss on defeasance of debt	-0-	(12)
Amortization of debt related costs	(5,069)	(5,336)
Unrealized holding gain	659	778
Change in valuation of derivative financial instruments	46,527	(182,990)
Assets contributed in aid of construction	7,637	6,950
Allowances for funds used during construction	4,549	3,303
Construction costs included in accounts payable	47,903	27,305

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION

The Sacramento Municipal Utility District (District) was formed and operates under the State of California Municipal Utility District Act (Act). The Act confers upon the District the rights and powers to fix rates and charges for commodities or services furnished, to incur indebtedness and issue bonds or other obligations, and under certain circumstances, to levy and collect ad valorem property taxes. As a public utility, the District is not subject to regulation or oversight by the California Public Utilities Commission. The District is responsible for the acquisition, generation, transmission, and distribution of electric power to its service area, which includes most of Sacramento County and a small adjoining portion of Placer County. The Board of Directors (Board) determines the District's rates. The District is exempt from payment of federal and state income taxes and real and personal property taxes.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting. The District's accounting records are maintained in accordance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board (FASB). The District's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission (FERC), except as it relates to the accounting for contributions of utility property in aid of construction (CIAC). The District's consolidated financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Electric revenues and costs that are directly related to generation, purchase, transmission, and distribution of electricity are reported as operating revenues and expenses. All other revenues and expenses are reported as non-operating revenues and expenses.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Financial Reporting Entity. These consolidated financial statements include the District and its component units. Although the component units are legally separate from the District, they are blended into and reported as part of the District because of the extent of their operational and financial relationships with the District. All significant inter-component transactions have been eliminated in consolidation.

Component Units. The component units include the Central Valley Financing Authority (CVFA), the Sacramento Cogeneration Authority (SCA), the Sacramento Power Authority (SPA), the Sacramento Municipal Utility District Financing Authority (SFA), and the Northern California Gas Authority No. 1 (NCGA). The primary purpose of CVFA, SCA, SPA and SFA is to own and operate electric utility plants that supply power to the District. The primary purpose of NCGA is to prepay for natural gas and to sell the natural gas to the District. The District's Board comprises the Commissions that govern these entities.

Plant in Service. The cost of additions to Plant in Service and replacement property units is capitalized. Repair and maintenance costs are charged to expense when incurred. When the District retires portions of its Electric Utility Plant, retirements are recorded against Accumulated Depreciation and the retired portion of Electric Utility Plant is removed from Plant in Service. The costs of removal and the related salvage value, if any, are charged or credited as appropriate to

Accumulated Depreciation. The District generally computes depreciation on Plant in Service on a straight-line, service-life basis. The consolidated average annual composite depreciation rates for 2007 and 2006 were 3.54 percent. Depreciation is calculated using the following estimated lives:

Generation	2.25 to 90 years
Transmission and Distribution	5 to 50 years
General	2 to 45 years

Investments in Joint Power Agency (JPA). The District's investment in the Transmission Agency of Northern California (TANC) is accounted for under the equity method of accounting and is reported as a component of Plant in Service. The District's share of the TANC debt service costs and operations and maintenance expense, inclusive of depreciation, is included in Transmission and Distribution expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets.

Investments in Gas Properties. The District has an approximate 22 percent non-operating ownership interest in the Rosa Unit gas properties in New Mexico of which, the District's portion of the extracted gas is transported for use in its natural gas-fired power plants (see Note 6). The District uses the successful efforts method of accounting for its investment in gas producing properties. Costs to acquire mineral interests in gas properties, to drill and equip exploratory wells that find proved reserves, and to drill and equip development wells are capitalized as a component of Plant in Service on the Consolidated Balance Sheets. Costs to drill exploratory wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed. Capitalized costs of producing gas properties, after considering estimated residual salvage values, are depleted by the unit-of-production method based on the estimated future production of the proved developed producing wells. The District's investment in gas properties is reported as a component of Plant in Service.

Restricted and Designated Assets. Cash, cash equivalents and investments, which are restricted under terms of certain agreements for payments to third parties or Board actions limiting the use of such funds, are included as restricted assets.

Restricted Bond Funds. The District's Indenture Agreements and Bond Resolutions require the maintenance of minimum levels of reserves for debt service and certain construction costs intended by the related debt offerings.

Nuclear Decommissioning Trust Fund. The District makes annual contributions to its Nuclear Decommissioning Trust Fund (Trust Fund) to cover the cost of its primary decommissioning activities associated with the Rancho Seco facility. Primary decommissioning excludes activities associated with the spent fuel storage facility after 2008 and most non-radiological decommissioning tasks. The District annually evaluates its contribution rate to ensure the Trust Fund will fully fund primary decommissioning by the end of 2008, the same year in which active decommissioning is planned to be complete (see Note 13). The annual contribution rate is determined in advance of each year, during the budget process, based on calculation of the planned expenditure rate over the remaining number of years estimated to complete the primary decommissioning activities. Changes in the estimate of the decommissioning liability serve to increase the contribution rate in future years (not in the year the estimate is updated, if changed).

Interest earnings on the Trust Fund assets are recorded as Interest Income and are accumulated in the Trust Fund. Annual Decommissioning expense comprises the District's annual contribution to the Trust Fund and the interest earnings on Trust Fund assets during the year.

Accrued Decommissioning. The District accrues decommissioning costs related to Utility Plant when an obligation to decommission facilities is legally required. Adjustments are made to such liabilities based on estimates by District staff in accordance with Statement of Financial Accounting Standards (SFAS) No. 143, *"Accounting for Asset Retirement Obligations" (ARO).* For active plants, such costs are included in the Utility Plant's cost and included as a component of Depreciation Expense over the Utility Plant's life. Expenditures for decommissioning activities are recorded as reductions to Accrued Decommissioning liability. Changes in Rancho Seco decommissioning liability estimates arising from inflation, annual accretion, and other changes to the cost assumptions are recorded directly to Accrued Decommissioning with a corresponding adjustment to the related regulatory deferral. The current portion of the Accrued Decommissioning liability represents the District's estimate of actual expenditures in the next year, generally as set forth in the annual budget.

The District has identified potential retirement obligations related to certain generation, distribution and transmission facilities. The District's non-perpetual leased land rights generally are renewed continuously because the District intends to utilize these facilities indefinitely. Since the timing and extent of any potential asset retirements are unknown, the fair value of any obligations associated with these facilities cannot be reasonably estimated. Accordingly, a liability has not been recorded.

At December 31, 2007 and 2006, the District's Accrued Decommissioning balance in the Consolidated Balance Sheets relating to Rancho Seco was $191.7 million and $247.5 million, respectively (see Note 13). The Accrued Decommissioning balance in the Consolidated Balance Sheets relating to other electricity generation and gas production facilities totaled $5.7 million and $5.3 million as of December 31, 2007 and 2006, respectively.

Securities Lending Transactions. The District lends its securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. District policy requires cash collateral of 102 percent of the market value of the loaned securities. Both the investments purchased, with the collateral received, and the related liability to repay the collateral are included in the Consolidated Balance Sheets.

Cash and Cash Equivalents. Cash and cash equivalents include all debt instruments purchased with an original maturity of 90 days or less, all investments in the Local Agency Investment Fund (LAIF), and money market mutual funds. LAIF has an equity interest in the State of California (State) Pooled Money Investment Account (PMIA). PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters, and maximum maturity of investments. The District's deposits with LAIF comprise cash representing demand deposits up to $40.0 million maximum, and cash equivalents representing amounts above $40.0 million which may be withdrawn after a thirty-day period. The debt instruments and money market mutual funds are reported at amortized cost which approximates fair value, and the LAIF is reported at the value of its pool shares.

Investments. The District's investments are reported at fair value. Realized and unrealized gains and losses are included in Interest and Other Income in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets. Premiums and discounts on zero coupon bonds are amortized using the effective interest method. Premiums and discounts on other securities are amortized using the straight-line method, which approximates the effective interest method.

Electric Operating Revenues. Electric revenues are billed on the basis of monthly cycle bills and are recorded as revenue when the electricity is delivered. The District records an estimate for unbilled revenues earned from the dates its retail customers were last billed to the end of the month. At December 31, 2007 and 2006, unbilled revenues were $61.2 million and $65.1 million, respectively.

Purchased Power Expenses. A portion of the District's power needs are provided through power purchase agreements. Expenses from such agreements, along with associated transmission costs paid to other utilities, are charged to Purchased Power expense on the Consolidated Statements of Revenues, Expenses and Changes in Net Assets in the period the power is received. The costs, or credits, associated with energy swap agreements (gas and electricity) or other arrangements that affect the net cost of Purchased Power are recognized in the period in which the underlying power delivery occurs. Contract termination payments and adjustments to prior billings are included in Purchased Power expense once the payments or adjustments can be reasonably estimated.

Advanced Capacity Payments. Some long-term agreements to purchase energy from other providers call for up-front payment. Such costs are generally recorded as an asset and amortized over the length of the contract.

Credit and Market Risk. The District enters into forward purchase and sales commitments for physical delivery of gas and electricity with utilities and power marketers. The District is exposed to credit risk related to nonperformance by its wholesale counterparties under the terms of these contractual agreements. In order to limit the risk of counterparty default, the District has a wholesale counterparty evaluation policy which includes the assignment of internal credit ratings to the District's counterparties based on counterparty and/or debt ratings, the requirement for credit enhancements for counterparties that do not meet an acceptable risk level, and the use of standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty. The District is also subject to similar requirements for many of its gas and electricity purchase agreements. As of December 31, 2007 and 2006, the District held $32.2 million and $27.8 million, respectively, on deposit by counterparties. The amount is recorded as unrestricted cash with an associated short-term and long-term liability. On January 23, 2007, the District entered into a $50 million letter of credit facility to support collateral requirements under the Districts various energy and natural gas purchase, sale and swap agreements.

Accounts Receivable and Allowance for Doubtful Accounts. Accounts Receivable are recorded at the invoiced amount and do not bear interest, except for accounts related to energy loans. The District recognizes an estimate of uncollectible accounts for its receivables related to electric service, wholesale activities, and conservation loans based upon its historical experience with collections and current energy market conditions. For large wholesale receivable balances, the District determines its bad debt reserves based on the specific credit issues for each account. The District records bad debts for its estimated uncollectible accounts related to electric service and wholesale activities as a reduction to the related operating revenues in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets. The District records bad debts for its estimated uncollectible accounts related to energy loans in Administrative, General and Customer expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets.

The summarized activity of the changes in the allowance for doubtful accounts during 2007 and 2006 is presented below (thousand of dollars):

	Balance at beginning of Year	Additions	Write-offs and Recoveries	Balance at end of Year
California ISO and PX:				
December 31, 2007	$ 24,577	$ 424	$ 759	$ 24,242
December 31, 2006	$ 24,274	$ 303	$ -0-	$ 24,577
Wholesale power and other:				
December 31, 2007	$ 1,305	$ 333	$ 389	$ 1,249
December 31, 2006	$ 913	$ 484	$ 92	$ 1,305
Retail Customers:				
December 31, 2007	$ 2,989	$ 6,707	$ 5,517	$ 4,179
December 31, 2006	$ 2,556	$ 5,320	$ 4,887	$ 2,989
Conservation Loans:				
December 31, 2007	$ 1,370	$ 1,405	$ 1,046	$ 1,729
December 31, 2006	$ 1,113	$ 396	$ 139	$ 1,370

Regulatory Deferrals. The Board has the authority to establish the level of rates charged for all District services. As a regulated entity, the District's financial statements are prepared in accordance with 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. Accordingly, certain expenses and credits, normally reflected in Net Increase (Decrease) in Net Assets as incurred, are recognized when included in rates and recovered from, or refunded to, customers. The District records various regulatory assets and credits to reflect rate-making actions of the Board.

Materials and Supplies. Materials and supplies are stated at average cost, which approximates the first-in, first-out method.

Unamortized Debt Issuance Costs. The costs incurred in connection with the issuance of debt obligations, principally underwriters fees and legal costs, are recorded as Unamortized Debt Issuance Costs in the consolidated balance sheets and are amortized over the terms of the related obligations using the bonds outstanding method, which approximates the effective interest method.

Compensated Absences. The District accrues vacation leave and compensatory time when employees earn the rights to the benefits. The District does not record sick leave or other leave as a liability until it is taken by the employee, since there are no cash payments for sick leave or other leave made when employees terminate or retire. At December 31, 2007 and 2006, the total estimated liability for vacation and other compensated absences was $22.6 million and $21.1 million, respectively.

Public Good. Public Good expenses consist of non-capital expenditures for energy efficiency programs, low income subsidies, renewable energy resources and technologies research and development.

Gains/Losses on Bond Refundings. Gains and losses resulting from bond refundings are included as a component of Long-Term Debt on the Consolidated Balance Sheets and amortized as a component of Interest on Debt in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets over the shorter of the life of the refunded debt or the new debt using the bonds outstanding method, which approximates the effective interest method.

Gains/Losses on Bond Defeasances. Gains and losses resulting from bond defeasances that were not financed with the issuance of new debt are included as a component of Interest on Debt in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets.

Allowance for Funds Used During Construction. The District capitalizes, as an additional cost of Construction Work In Progress (CWIP), an Allowance for Funds Used During Construction (AFUDC), which represents the cost of borrowed funds used for such purposes. The amount capitalized is determined by a formula prescribed by FERC. The AFUDC rates for 2007 and 2006 were 4.2 percent and 3.9 percent, respectively, of eligible CWIP.

Derivative Financial Instruments. The District records derivative financial instruments (interest rate swap and gas price swap agreements, certain wholesale sales agreements, certain electricity purchase agreements and option agreements) at fair value on its Consolidated Balance Sheets. The District generally does not enter into agreements for trading purposes. However, the District does not elect hedge accounting. Fair market value is estimated by comparing contract prices to forward market prices quoted by third party market participants and/or provided in relevant industry publications. The Board defers recognition of the unrealized gains or losses from such instruments for rate-making purposes. The District is exposed to risk of nonperformance if the counterparties default or if the swap agreements are terminated. The District reports derivative financial instruments with remaining maturities of one year or less and the portion of long-term contracts with scheduled transactions over the next twelve months as current on the Consolidated Balance Sheets.

Interest Rate Swap Agreements. The District enters into interest rate swap agreements to modify the effective interest rates on outstanding debt. Interest expense is reported net of the swap payments received or paid as a component of Interest on Debt in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets.

Gas and Electricity Price Swap and Option Agreements. The District uses forward contracts to hedge the impact of market volatility on gas commodity prices for its gas-fueled power plants and for energy prices on purchased power for the District's retail load. Net cash payments or receipts incurred under the price swap and option agreements are reported as a component of Production for fuel related contracts and Purchased Power for electricity contracts in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets over the periods of the agreements.

Precipitation Hedge Agreements. The District enters into non-exchange traded precipitation hedge agreements to hedge the increased cost of power caused by low precipitation years (Precipitation Agreements). The District records the intrinsic value of the Precipitation Agreements on the Consolidated Balance Sheets. Settlement of the Precipitation Agreements is not performed until the end of the period covered (water year ended September 30). The intrinsic value of a Precipitation Agreement is the difference between the expected results from a monthly allocation of the cumulative rainfall amounts, in an average rainfall year, and the actual rainfall during the same period.

Insurance Programs. The District records liabilities for unpaid claims at their present value when they are probable of occurrence and the amount can be reasonably estimated. The District records a liability for unpaid claims associated with general, auto, workers' compensation, and short-term and long-term disability based upon estimates derived by the District's claims administrator or District staff. The liability comprises the present value of the claims outstanding, and includes an amount for claim events incurred but not reported based upon the District's experience.

Net Assets. The District classifies its net assets into three components as follows:

- **Invested in capital assets, net of related debt** — This component of net assets consists of capital assets, net of Accumulated Depreciation reduced by the outstanding debt balances, net of unamortized debt expenses.
- **Restricted** — This component consists of net assets with constraints placed on their use, either externally or internally. Constraints include those imposed by debt indentures (excluding amounts considered in net capital, above), grants or laws and regulations of other governments, or by law through constitutional provisions or enabling legislation or by the Board.
- **Unrestricted** — This component of net assets consists of net assets that do not meet the definition of "invested in capital, net of related debt" or "restricted."

Contributions in Aid of Construction. The District records CIAC from customer contributions, primarily relating to expansions to the District's distribution facilities, as Nonoperating Revenues in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets. Contributions of capital are valued at estimated market cost. For rate-making purposes, the Board does not recognize such revenues when received; rather, CIAC is included in revenues as such costs are amortized over the estimated useful lives of the related distribution facilities.

Grants. The District receives grant proceeds from federal and state assisted programs for its advanced and renewable technologies, electric vehicle, and energy efficiency programs. The District also periodically receives grant proceeds from federally assisted programs as partial reimbursements for costs it has incurred as a result of storm damages. When applicable, these programs may be subject to financial and compliance audits pursuant to regulatory requirements. The District considers the possibility of any material disallowances to be remote. During 2007 and 2006, the District recognized grant proceeds of $0.5 million and $2.8 million, respectively, as a component of Interest and Other Income, in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets.

Recent Accounting Pronouncements. In June 2004, GASB issued Statement of Government Accounting Standards (SGAS) No. 45, *"Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions" (OPEB)* (GASB No. 45), which establishes standards of accounting and financial reporting for OPEB expense and related OPEB liabilities or assets. OPEB arises from an exchange of salaries and benefits for employee services rendered. It refers to postemployment benefits other than pension benefits such as postemployment healthcare benefits. This Statement is effective for the District beginning in 2007. See Note 15.

In November 2006, GASB issued SGAS No. 49, *"Accounting and Financial Reporting for Pollution Remediation Obligations"* (GASB No. 49). GASB No. 49 requires local governments to provide the public with better information about the financial impact of environmental cleanups. A government would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and if certain events have occurred. This Statement is effective for the District beginning in 2008. The District is currently assessing the financial statement impact of adopting the new Statement, but does not believe that its impact will be material.

In June 2007, GASB issued SGAS No. 51, *"Accounting and Financial Reporting for Intangible Assets"* (GASB No. 51). GASB No. 51 provides guidance regarding how to identify, account for and report intangible assets. Intangible assets are defined as assets that lack physical substance, are nonfinancial in nature, and have an initial useful life extending beyond a single reporting period. GASB No. 51 provides that intangible assets be classified as capital assets, except for items explicitly excluded from the scope of the standard. This Statement is effective for the District beginning in 2010. The District is currently assessing the financial statement impact of adopting the new Statement, but does not believe that its impact will be material.

In September 2006, FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (FASB No. 157). FASB No. 157 provides guidance for using fair value to measure assets and liabilities. The standard clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability. The standard also establishes a fair value hierarchy that prioritizes the information used to develop these assumptions. This Statement is effective for the District beginning in 2008. The District is currently assessing the financial statement impact of adopting the new Statement, but does not believe that its impact will be material.

GASB 47. Effective January 1, 2006, the District adopted SGAS No. 47, *"Accounting for Termination Benefits"* (GASB No. 47). GASB No. 47 establishes standards of accounting and financial reporting for termination benefits. Termination benefits are benefits provided to employees as an incentive to hasten the termination of services, as a result of a voluntary early termination, or as a consequence of involuntary early termination. Under the standard, all termination benefits, including voluntary and involuntary benefits, must be recorded as a liability and expense. Upon initial recognition, a liability is recorded for voluntary termination benefits when employees accept the offer, and amounts can be estimated. Involuntary termination benefits should be recognized when the plan has been communicated to employees and amounts can be estimated. Measurement of the liability should be updated over future service periods.

The District has identified a termination benefit liability related to certain employees at the Rancho Seco Decommissioning site, which will complete non-radiological decommissioning in 2008. There are voluntary separation programs and retention agreements for certain employees, and if required reductions have not been achieved, an involuntary separation program will be instituted. Benefits provided include up to six months of paid Consolidated Omnibus Reconciliation Act of 1985 (COBRA) medical benefits, outplacement services, and severance, based on length of service and type of termination agreement. Employees with sufficient length of service are eligible for OPEB after termination. As of December 31, 2007, 22 employees had retention agreements totaling $1.4 million, recorded as a component of Customer Deposits and Other on the Consolidated Balance Sheets. Prior to the new standard, the District had recorded termination benefits; therefore, no initial amount was reported as an adjustment to net assets.

Customer Sales and Excise Taxes. The District is required by various governmental authorities, including states and municipalities, to collect and remit taxes on certain customer sales. Such taxes are presented on a net basis and excluded from revenues and expenses in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets.

Reclassifications. Certain amounts in the 2006 consolidated financial statements have been reclassified in order to conform to the 2007 presentation.

NOTE 3. ACCOUNTING CHANGE

EITF Issue No. 06-03. Effective January 1, 2007, the District adopted the Emerging Issues Task Force (EITF) Issue No. 06-03, *"How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation)"*. Included in the scope of this issue are any taxes assessed by a governmental authority that are imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added and some excise taxes. The EITF concluded that the presentation of such taxes on a gross basis (included in revenues and costs) or a net basis (excluded from revenues) is an accounting policy decision that should be disclosed pursuant to Accounting Principles Board Opinion No. 22, *"Disclosure of Accounting Policies"*. The accounting policy disclosures required by this consensus are included in Note 2 under the heading *"Customer Sales and Excise Taxes."*

NOTE 4. UTILITY PLANT

The summarized activity of the District's utility plant during 2007 is presented below (thousands of dollars):

	Balance December 31, 2006	Additions	Transfers and Deletions	Balance December 31, 2007
Nondepreciable Utility Plant:				
Land	$ 87,122	$ 3,128	$ -0-	$ 90,250
CWIP	224,579	288,377	(263,631)	249,325
Total nondepreciable utility plant	311,701	291,505	(263,631)	339,575
Depreciable Utility Plant:				
Generation	1,275,139	109,971	(11,566)	1,373,544
Transmission	194,812	6,314	37	201,163
Distribution	1,326,003	87,437	(15,372)	1,398,068
Investment in gas properties	160,031	11,984	-0-	172,015
Investment in JPAs	9,985	338	-0-	10,323
General	721,751	43,161	(8,249)	756,663
	3,687,721	259,205	(35,150)	3,911,776
Less: accumulated depreciation and depletion	(1,261,750)	(141,599)	37,528	(1,365,821)
Less: accumulated amortization on JPAs	(2,896)	(313)	-0-	(3,209)
	(1,264,646)	(141,912)	37,528	(1,369,030)
Total depreciable plant	2,423,075	117,293	2,378	2,542,746
Total Utility Plant — net	$ 2,734,776	$ 408,798	$ (261,253)	$ 2,882,321

The summarized activity of the District's utility plant during 2006 is presented below (thousands of dollars):

	Balance December 31, 2005	Additions	Transfers and Deletions	Balance December 31, 2006
Nondepreciable Utility Plant:				
Land	$ 73,477	$ 13,645	$ -0-	$ 87,122
CWIP	682,160	189,238	(646,819)	224,579
Total nondepreciable utility plant	755,637	202,883	(646,819)	311,701
Depreciable Utility Plant:				
Generation	811,072	465,705	(1,638)	1,275,139
Transmission	188,169	11,566	(4,923)	194,812
Distribution	1,241,704	90,477	(6,178)	1,326,003
Investment in gas properties	144,777	15,254	-0-	160,031
Investment in JPAs	9,649	336	-0-	9,985
General	664,399	64,055	(6,703)	721,751
	3,059,770	647,393	(19,442)	3,687,721
Less: accumulated depreciation and depletion	(1,150,513)	(132,873)	21,636	(1,261,750)
Less: accumulated amortization on JPAs	(2,583)	(313)	-0-	(2,896)
	(1,153,096)	(133,186)	21,636	(1,264,646)
Total depreciable plant	1,906,674	514,207	2,194	2,423,075
Total Utility Plant — net	$ 2,662,311	$ 717,090	$ (644,625)	$ 2,734,776

In 2002, the District began active development of the Cosumnes Power Plant (CPP Project), a 500 megawatt (MW) natural gas-fueled generation facility located on the Rancho Seco site. The CPP Project became operational on February 24, 2006 (see Note 6 for component unit information and Note 18 relating to construction contract issues). Included in Utility Plant and CWIP at December 31, 2007 and 2006, are cumulative capitalized costs of $480.2 million and $469.4 million, respectively, relating to the CPP Project construction and development, including the related natural gas pipeline.

NOTE 5. INVESTMENT IN JOINT POWERS AGENCY

TANC. The District and fourteen other California municipal utilities are members of TANC, a JPA. TANC, along with the other California municipal utilities, own and operate the California-Oregon Transmission Project (COTP), a 500-kilovolt transmission line between central California and southern Oregon. The District is obligated to pay 27.1 percent of TANC's COTP debt service and operations costs in exchange for ownership of 339 MW of TANC's 1,269 MW transfer capability. Additionally, the District has a 46 MW share of TANC's 300 MW firm, bi-directional transmission over Pacific Gas and Electric's (PG&E) system between PG&E's Tesla and Midway substations. The District recorded transmission expenses related to TANC of $13.2 million and $11.4 million in 2007 and 2006, respectively.

Summary financial information for TANC is presented below:

	December 31, 2007 (Unaudited)	December 31, 2006 (Unaudited)
	(thousands of dollars)	
Total assets	$ 436,804	$ 437,963
Total liabilities	$ 434,224	$ 436,631
Total net assets	2,580	1,332
Total liabilities and net assets	$ 436,804	$ 437,963
Changes in net assets for the six months ended December 31	$ (458)	$ 951

The long-term debt of TANC, which totals $371.7 million (unaudited) at December 31, 2007, is collateralized by a pledge and assignment of net revenues of TANC supported by take-or-pay commitments of the District and other members. Should other members default on their obligations to TANC, the District would be required to make additional payments to cover a portion of such defaulted payments, up to 25 percent of its current obligation of 27.1 percent.

In October 2007, TANC entered into a sales and purchase agreement with the City of Vernon (Vernon) whereby TANC will purchase entitlement, rights, title and interest in Vernon's COTP transmission assets (approximately 121 MW North-to-South). TANC expects the assignment and transfer of Vernon's COTP entitlement to occur within the first quarter of 2008. The District has not yet determined the impact on its entitlement share, transmission expenses, or debt obligation.

Copies of the TANC annual financial reports may be obtained from the District at 6201 S Street, P.O. Box 15830, Sacramento, California 95852.

NOTE 6. COMPONENT UNITS

CVFA Carson Cogeneration Project. CVFA is a JPA formed by the District and the Sacramento Regional County Sanitation District. CVFA operates the Carson Project, a 57 MW (net) natural gas-fired cogeneration facility and a 43 MW (net) natural gas-fired simple cycle peaking plant, which is financed primarily by CVFA non-recourse revenue bonds.

SFA Cosumnes Power Plant Project. SFA is a JPA formed by the District and the Modesto Irrigation District. SFA operates the CPP Project, a 500 MW (net) natural gas-fired, combined cycle facility, which is financed primarily by SFA non-recourse revenue bonds.

SCA Procter & Gamble Cogeneration Project. SCA is a JPA formed by the District and the SFA. SCA operates the Procter & Gamble Project, a 120 MW (net) natural gas-fired cogeneration facility and a 44 MW (net) natural gas-fired simple cycle peaking plant, which is financed primarily by SCA non-recourse revenue bonds.

SPA Campbell Soup Cogeneration Project. SPA is a JPA formed by the District and the SFA. SPA operates the Campbell Soup Project, a 160 MW (net) natural gas-fired cogeneration facility, which is financed primarily by SPA non-recourse revenue bonds.

NCGA Northern California Gas Authority No. 1. NCGA is a JPA formed by the District and the SFA. NCGA has a twenty-year prepaid gas contract with Morgan Stanley Capital Group (MSCG), which is financed primarily by NCGA non-recourse revenue bonds. The District has contracted with NCGA to purchase all of the gas delivered to NCGA pursuant to the gas contract with MSCG. NCGA is obligated to pay the principal and interest on the Bonds. The District is obligated to purchase and pay for gas tendered for delivery by NCGA at market prices and is not obligated to make payments in respect to debt service on the Bonds.

As described in Note 2, all of the activities and balances of the component units are blended into and reported as part of the District because of the extent of their operational and financial relationships with the District. Copies of CVFA's, SCA's, SPA's, SFA's and NCGA's annual financial reports may be obtained from their Executive Office at 6201 S Street, P.O. Box 15830, Sacramento, California 95852.

NOTE 7. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash Equivalents and Investments. The District's investment policies are governed by the California State and Municipal Codes and its Indenture, which restricts District investment securities to obligations which are unconditionally guaranteed by the United States (U.S.) Government or its agencies or instrumentalities; direct and general obligations of the State or any local agency within the State; bankers' acceptances; certificates of deposit; repurchase agreements; and taxable government and tax-exempt money market portfolios. The District's investment policy includes restrictions for investments relating to maximum amounts invested as a percentage of total portfolio and with a single issuer, maximum maturities, and minimum credit ratings.

Credit Risk. To mitigate the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment, the District limits investments to those rated, at a minimum, "A-1" or equivalent for commercial paper and "A" or equivalent for medium-term corporate notes by a nationally recognized rating agency.

Custodial Credit Risk. This is the risk that, in the event of the failure of a depository financial institution or counterparty to a transaction, the District's deposits may not be returned or the District will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of another party. The District does not have a deposit policy for custodial credit risk. As of December 31, 2007, $4.2 million in deposits were uninsured. Additionally, at December 31, 2007 and 2006, $75.3 million and $76.1 million, respectively, in commercial paper and repurchase agreements were held by a counterparty that was acting as the District's agent in securities lending transactions.

Concentration of Credit Risk. This is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. The District places no limit on the amounts invested in any one issuer for repurchase agreements and federal agency securities. The following are the concentrations of risk greater than 5 percent in either year:

	December 31, 2007	December 31, 2006
Investment Type:		
Federal National Mortgage Association (Fannie Mae)	9%	16%
Federal Home Loan Banks	22%	15%
Federal Home Loan Mortgage Corporation (Freddie Mac)	5%	10%
Morgan Stanley Repurchase Agreements	8%	7%

Interest Rate Risk. This is the risk of loss due to the fair value of an investment falling due to interest rates rising. Though the District has restrictions as to the maturities of some of the investments, it does not have a formal policy that limits investment maturities as means of managing its exposure to fair value losses arising from increasing interest rates.

Securities Lending Transactions. The District is authorized by its investment policy and by California Government Code to enter into securities lending agreements for up to 20 percent of its investment portfolio, not to exceed $75.0 million, only with counterparties that are primary dealers of the Federal Reserve Bank of New York. There have been no violations of the provisions of the authorization during 2007 or 2006. The maturities of the investments made, which are repurchase agreements and commercial paper, match the maturities of the securities loaned, which are U.S. Treasuries and Agencies. At December 31, 2007 and 2006, the District had no credit risk exposure to borrowers because the amount the District owes the borrowers exceeds the amounts the borrowers owe the District. The contract with the District's custodial bank requires it to indemnify the District if the borrowers fail to return the securities (and the collateral is inadequate to replace the securities lent), or fail to pay the District for income distributions by the securities' issuers while the securities were on loan. The District cannot pledge or sell collateral securities without borrower default. The District receives cash collateral and invests in certain securities allowed for in the securities lending agreement. These investments were in Repurchase Agreements and Commercial Paper in the amount of $69.1 million and $6.2 million, respectively, as of December 31, 2007. The fair market value equals the carrying amount for the both the Repurchase Agreements and Commercial Paper.

Interest Rate Swap Agreement. The District has a variable-to-variable rate swap agreement with an initial notional amount of $100.0 million for the purpose of exchanging earnings on short-term assets in the investment portfolio for earnings based on a longer term investment rate without sacrificing liquidity. The swap agreement expires in June 2016. Under the terms of the swap agreement, the District pays a variable rate equal to the 90-day LIBOR rate and receives a variable rate of the 10-year LIBOR minus .347 percent. The Standard and Poor's (S&P) credit rating of the counterparty is AA-. This swap was terminated by the District on January 3, 2008. The District received a $3.7 million termination payment.

The following schedules indicate the credit and interest rate risk at December 31, 2007 and 2006. The credit ratings listed are from S&P. N/A is defined as not applicable to the rating disclosure requirements.

At December 31, 2007, the District's cash, cash equivalents and investments consist of the following:

		Remaining Maturities (in years)			
Description	**Credit Rating**	**Less Than 1**	**1–5**	**More than 5**	**Total Fair Value**
Cash and Cash Equivalents:					
LAIF	Not Rated	$ 43,395	$ -0-	$ -0-	$ 43,395
Money market mutual funds	AAAm	81,162	-0-	-0-	81,162
Certificates of Deposits	A-1/AAA/A-1+	100,000	-0-	-0-	100,000
Fannie Mae	A-1+	12,141	-0-	-0-	12,141
Federal Home Loan Banks	A-1+	18,682	-0-	-0-	18,682
Commercial paper	A-1/A-1+	55,279	-0-	-0-	55,279
Repurchase agreements	Not Rated	69,131	-0-	-0-	69,131
Total cash and cash equivalents		379,790	-0-	-0-	379,790
Investments:					
Fannie Mae	AAA/A-1+	27,264	14,986	4,988	47,238
Federal Farm Credit Bonds	AAA	6,586	2,256	-0-	8,842
Federal Home Loan Banks	AAA	89,925	34,927	-0-	124,852
Freddie Mac	AAA	997	30,936	-0-	31,933
Guaranteed Investment Contract	Not Rated	-0-	-0-	10,698	10,698
United States Treasuries	N/A	-0-	32,122	-0-	32,122
Corporate Note	AAA	-0-	9,877	5,012	14,889
Total investments		124,772	125,104	20,698	270,574
Total cash, cash equivalents and investments		$ 504,562	$ 125,104	$ 20,698	$ 650,364

At December 31, 2006, the District's cash, cash equivalents and investments consist of the following:

		Remaining Maturities (in years)			
Description	Credit Rating	Less Than 1	1–5	More than 5	Total Fair Value
Cash and Cash Equivalents:					
LAIF	Not Rated	$ 470	$ -0-	$ -0-	$ 470
Money market mutual funds	AAAm	113,571	-0-	-0-	113,571
Certificates of Deposits	A-1/AA+/A-1+	125,000	-0-	-0-	125,000
Commercial paper	A-1/A-1+	41,897	-0-	-0-	41,897
Repurchase agreements	Aaa	73,086	-0-	-0-	73,086
Total cash and cash equivalents		354,024	-0-	-0-	354,024
Investments:					
Fannie Mae	AAA	53,815	55,450	4,859	114,124
Federal Farm Credit Bonds	AAA	-0-	2,232	-0-	2,232
Federal Home Loan Banks	AAA	44,865	61,069	-0-	105,934
Freddie Mac	AAA	31,935	40,046	-0-	71,981
Guaranteed Investment Contract	Not Rated	-0-	-0-	10,698	10,698
United States Treasuries	N/A	10,845	22,524	-0-	33,369
Corporate Note	A+/AA-/AAA	-0-	14,034	4,992	19,026
Commercial paper	A-1/A-1+	1,973	-0-	-0-	1,973
Total investments		143,433	195,355	20,549	359,337
Total cash, cash equivalents and investments		$ 497,457	$ 195,355	$ 20,549	$ 713,361

At December 31, 2007 and 2006, the District reported its book overdraft of $0.1 million and $0.8 million, respectively, as a component of Accounts Payable on the Consolidated Balance Sheets.

The District's cash, cash equivalents, and investments are classified in the Consolidated Balance Sheets as follows:

	December 31, 2007	December 31, 2006
	(thousands of dollars)	
Total Cash, Cash Equivalents and Investments:		
Revenue bond reserve, debt service and construction funds:		
Revenue bond reserve fund	$ 73,428	$ 76,551
Debt service fund	53,636	58,901
Component unit bond reserve and construction funds	116,283	96,491
Total revenue bond reserve, debt service and construction funds	243,347	231,943
Nuclear decommissioning trust fund	69,865	82,315
Rate stabilization fund	91,143	107,100
Securities lending collateral	75,284	76,086
Other restricted funds	803	1,181
Unrestricted funds	169,922	214,736
Total cash, cash equivalents and investments	$ 650,364	$ 713,361

NOTE 8. REGULATORY DEFERRALS

The Board has taken various regulatory actions that result in differences between the recognition of revenues and expenses for rate-making purposes and their treatment under generally accepted accounting principles for non-regulated entities. These actions result in regulatory assets and liabilities, which are summarized in the tables below. Changes to these balances, and their inclusion in rates, occur only at the direction of the Board.

Regulatory Assets

Decommissioning. The District's regulatory asset relating to the unfunded portion of its decommissioning liability is being collected in rates and through interest earnings on the Trust Fund through 2008, when radiological decommissioning is expected to be complete. Subsequently, nuclear fuel storage costs and non-radiological decommissioning costs are to be collected in rates commencing in 2009.

Wholesale Power Receivables. The District's regulatory asset relates to its wholesale receivables that were fully reserved as uncollectible in 2001. These wholesale receivable reserves relate to amounts due from the California PX totaling $24.2 million and $24.6 million at December 31, 2007 and 2006, respectively. The ultimate recovery of these amounts is dependent on numerous factors and cannot be determined at this time. This regulatory asset will be reversed concurrent with the reasonable certainty of collections, or by inclusion in rates in future periods.

TANC Operations Costs. The District's regulatory asset relating to deferred TANC costs comprises the difference between its cash payments made to TANC and its share of TANC's accrual-based costs of operations. This regulatory asset is being collected in rates over the life of TANC's assets during the period that cash payments to TANC exceed TANC's accrual-based costs.

U.S. Bureau of Reclamation. In December 2004, the District established a regulatory asset to defer recognizing the expense related to the settlement with the U.S. Bureau of Reclamation (Bureau) on a billing dispute. The District will make increased payments in future rates to settle the dispute (see Note 18). This regulatory asset will be collected in rates for future water service over the twenty-five year period the District is committed to making the increased rate payments to the Bureau.

Enrichment Facility Decommissioning Assessment. The District's regulatory asset relating to obligations associated with the federal nuclear fuel enrichment program is being collected in rates, based on cash payments made, through 2008.

Precipitation Hedges. Settlements of Precipitation Agreements are included in rates in the year settled and accordingly, the intrinsic value of open precipitation hedges is deferred as regulatory assets or liabilities.

The District's total regulatory costs for future recovery are presented below:

	December 31, 2007	December 31, 2006
	(thousands of dollars)	
Regulatory Costs for Future Recovery:		
Decommissioning	$ 137,998	$ 170,243
Wholesale power receivables	24,242	24,577
TANC operations costs	6,571	8,856
U.S. Bureau of Reclamation	6,200	5,790
Enrichment facility decommissioning assessment	1,215	2,431
Precipitation hedges	-0-	-0-
Total regulatory costs	176,226	211,897
Less: regulatory costs to be recovered within one year	(39,464)	(57,763)
Total regulatory costs for future recovery — net	$ 136,762	$ 154,134

Regulatory Liabilities

CIAC. In 2007 and 2006, the District capitalized CIAC totaling $24.4 million and $23.7 million, respectively, in Plant in Service in the Consolidated Balance Sheets and recorded $7.6 million and $7.0 million, respectively, of Depreciation Expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets. The District's regulatory credit relating to CIAC is intended to offset the revenue and expense associated with this accounting treatment. Thus, this regulatory credit is being amortized into rates over the depreciable lives of the related contributed distribution plant assets in order to offset the earnings effect of these nonexchange transactions.

Derivative Financial Instruments. The District's regulatory credit relating to derivative financial instruments is intended to defer the net difference between the fair value of derivative instruments and their cost basis, if any. Derivatives are reflected in rates at contract cost and as such, the balance is charged or credited into rates as the related asset or liability is utilized.

Rate Stabilization. The District's regulatory credit relating to Rate Stabilization is intended to defer the need for future rate increases when costs exceed existing rates. At the direction of the Board, amounts may be either transferred into this fund (which reduces revenues), or amounts are transferred out of this fund (which increases revenues). The Board authorizes Rate Stabilization Fund transfers on an event driven basis.

Public Good. The District's regulatory credit relating to Public Good comprises the amounts collected in rates for specifically identified Public Good programs that have not been fully expended. These regulatory deferrals are credited to revenue in the period when the expenditures on identified projects occur.

The District's total regulatory credits for future revenue recognition are presented below:

	December 31, 2007	December 31, 2006
	(thousands of dollars)	
Regulatory Credits for Future Revenue Recognition:		
CIAC	$ 208,733	$ 191,949
Derivative financial instruments	79,354	32,645
Rate stabilization	91,143	107,100
Precipitation hedges	10,696	36
Public good	2,097	3,347
Total regulatory credits for future revenue recognition	392,023	335,077
Less: regulatory credits to be recognized within one year	(31,037)	(18,879)
Total regulatory credits — net	$ 360,986	$ 316,198

NOTE 9. DERIVATIVE FINANCIAL INSTRUMENTS

The District enters into contracts for electricity and natural gas to meet the expected needs of its retail customers. The District sells excess capacity during periods when it is not needed to meet its retail requirements. The District's energy risk management program uses various physical and financial contracts to hedge exposure to fluctuating commodity prices. The District also enters into interest rate swap agreements to reduce interest rate risk, or to enhance the relationship between the risk and return regarding the District's assets or debt obligations. During 2007 and 2006, the District executed numerous new gas related and power related purchase agreements, some of which are recorded as derivative financial instruments and are included in the table below.

The fair value of the District's derivative financial instruments are as follows:

	December 31, 2007	December 31, 2006
	(thousands of dollars)	
Derivative Financial Instrument Assets:		
Gas related agreements	$ 81,806	$ 59,897
Electric related agreements	2,068	-0-
Treasury related agreements	27,050	23,732
Total derivative financial instrument assets	110,924	83,629
Less: derivative financial instruments maturing within one year	(22,870)	(35,503)
Total derivative financial instrument assets — net	$ 88,054	$ 48,126
Derivative Financial Instrument Liabilities:		
Gas related agreements	$ 5,319	$ 34,122
Electric related agreements	3,307	-0-
Treasury related agreements	19,920	13,657
Total derivative financial instruments liabilities	28,546	47,779
Less: derivative financial instruments maturing within one year	(10,344)	(25,725)
Total derivative financial instrument liabilities — net	$ 18,202	$ 22,054

The Board has deferred recognition of the effects of reporting the fair value of derivative financial instruments for rate-making purposes, and maintains regulatory accounts to defer the accounting impact of these accounting adjustments (see Note 8). Market values may have changed significantly since December 31, 2007.

NOTE 10. LONG-TERM DEBT

The District's total long-term debt is presented below:

	December 31, 2007	December 31, 2006
	(thousands of dollars)	
Electric Revenue Bonds:		
Electric revenue bonds, 2.5%–6.5%, 2008–2033	$ 1,544,425	$ 1,603,590
Subordinated electric revenue bonds, 2.9%–8.0%, 2008–2028	443,400	469,425
Total electric revenue bonds	1,987,825	2,073,015
Component unit project revenue bonds, 3.0%–5.5%, 2008–2030	541,390	554,280
Gas supply prepayment bonds 3.85%–5.0%, 2008–2027	757,055	-0-
Total long-term debt outstanding	3,286,270	2,627,295
Bond premiums — net	73,074	79,221
Deferred losses on bond refundings — net	(79,763)	(90,127)
Total long-term debt	3,279,581	2,616,389
Less: amounts due within one year	(106,365)	(98,080)
Total long-term debt — net	$ 3,173,216	$ 2,518,309

The summarized activity of the District's long-term debt during 2007 is presented below (thousands of dollars):

	December 31, 2006	Additions	Payments or Amortization	December 31, 2007	Amounts Due Within One Year
Electric revenue bonds	$ 1,603,590	$ -0-	$ (59,165)	$ 1,544,425	$ 61,825
Subordinate electric revenue bonds	469,425	-0-	(26,025)	443,400	12,450
Component unit project revenue bonds	554,280	-0-	(12,890)	541,390	13,425
Gas supply prepayment bonds	-0-	757,055	-0-	757,055	18,665
Total	2,627,295	757,055	(98,080)	3,286,270	$ 106,365
Unamortized premiums — net	79,221	2,618	(8,765)	73,074	
Deferred losses on bond refundings — net	(90,127)	-0-	10,364	(79,763)	
Total long-term debt	$ 2,616,389	$ 759,673	$ (96,481)	$ 3,279,581	

The summarized activity of the District's long-term debt during 2006 is presented below (thousands of dollars):

	December 31, 2005	Additions	Payments or Amortization	December 31, 2006	Amounts Due Within One Year
Electric revenue bonds	$ 1,669,250	$ -0-	$ (65,660)	$ 1,603,590	$ 59,165
Subordinate electric revenue bonds	478,425	-0-	(9,000)	469,425	26,025
Component unit project revenue bonds	263,485	300,375	(9,580)	554,280	12,890
Total	2,411,160	300,375	(84,240)	2,627,295	$ 98,080
Unamortized premiums — net	75,813	13,129	(9,721)	79,221	
Deferred losses on bond refundings — net	(101,445)	-0-	11,318	(90,127)	
Total long-term debt	$ 2,385,528	$ 313,504	$ (82,643)	$ 2,616,389	

At December 31, 2007, scheduled annual principal maturities and interest are as follows (thousands of dollars):

	Principal	Interest	Total
2008	106,365	155,186	261,551
2009	108,605	150,436	259,041
2010	137,150	145,047	282,197
2011	143,970	137,216	281,186
2012	148,855	130,024	278,879
2013 – 2017	838,625	539,239	1,377,864
2018 – 2022	813,380	340,253	1,153,633
2023 – 2027	764,160	157,747	921,907
2028 – 2032	209,710	25,112	234,822
2033	15,450	772	16,222
Total Requirements	$ 3,286,270	$ 1,781,032	$ 5,067,302

Interest in the preceding table includes interest requirements for variable rate debt using the debt interest rate of 4.03 percent in effect at December 31, 2007 for the issue.

2007 Revenue Bonds. On May 16, 2007, NCGA issued $757.1 million of 2007A and 2007B Series NCGA Revenue Bonds. The proceeds of the offering were used to finance the prepayment for a twenty-year supply of natural gas. As discussed in Note 6, NCGA is obligated to pay the debt service on the Bonds. The District's obligation is limited to the purchase and payment for gas tendered for delivery by NCGA.

2006 Revenue Bonds. On January 19, 2006, SFA issued $300.4 million of 2006 Series SFA Revenue Bonds. The proceeds of the offering were used to purchase the CPP Project from the District.

2006 Revenue Bonds Refunding and Redemptions. In July 2006, CVFA redeemed $1.9 million of CVFA Bonds 1993 Series due in July 2009 at a cost of $1.9 million. This bond redemption resulted in a current accounting loss of $12 thousand, which is included in Interest on Debt in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets. Redeeming the bonds will reduce the aggregate future debt service payments by $2.2 million.

Interest Rate Swap Agreements. A summary of the Districts four swap agreements are as follows:

Initial Notional Amount (000's)	District Pays	Fixed Rate	Floating Rate	Termination Date	Counterparty Credit Rating (S&P)
$ 269,095	Fixed	4.345%	70% of LIBOR	08/15/18	AAA
131,030	Variable	5.154%	BMA	07/01/24	AA-
111,900	Fixed	2.894%	63% of LIBOR	08/15/28	AA-
39,470	Fixed	4.500%	65% of LIBOR	07/01/10	AA-

The District has a fixed-to-variable interest rate swap agreement with an initial notional amount of $131.0 million, which is equivalent to the principal amount of the District's 1997 Series K Electric Revenue Bonds. Under this swap agreement, the District pays a variable rate equivalent to the Bond Market Association (BMA) Index (3.42 percent at December 31, 2007) and receives fixed rate payments of 5.154 percent. In connection with the swap agreement, the District has a put option agreement, also with an initial notional amount of $131.0 million, which gives the counterparty the right to sell to the District, at par, either the 1997 Series K Bonds, or a portfolio of securities sufficient to defease the 1997 Series K Bonds. The exercise of the option terminates the swap at no cost to the District. The term of both the swap and the put is equal to the maturity of the 1997 Series K Bonds.

Additionally, the District has three variable-to-fixed interest rate swap agreements with a combined initial notional amount of $420.5 million for the purpose of fixing the effective interest rate associated with certain of its Subordinated Bonds. The notional values of all three swaps are amortized over the life of the respective swap agreements. The District can terminate all swap agreements at any time, with payment or receipt of the fair market value of the swaps as of the date of termination.

In September 2005, the District entered into a variable-to-fixed swap agreement with a counterparty to hedge interest rate risk on the CPP Project financing, which subsequently funded on January 19, 2006. The swap had a notional amount of $257.0 million and was scheduled to amortize through 2030. Although the agreement was scheduled to become effective March 1, 2006, the intent was to terminate and cash settle the swap upon funding of the CPP Project. Consequently, on January 19, 2006 the swap cash settled with a $2.0 million payment from the counterparty.

Subordinated Electric Revenue Bonds. Payment of and interest on the Subordinated Electric Revenue Bonds is subordinate to the payment of the principal and interest on the District's Electric Revenue Bonds.

Variable Rate Bonds. The District's Variable Rate Bonds bear interest at daily, weekly, and monthly rates, ranging from 3.50 percent to 3.80 percent at December 31, 2007. The District can elect to change the interest rate period or fix the interest rate, with certain limitations. The District's Variable Rate Bonds cannot be put to the District by the bondholders. Accordingly, the District has recorded such bonds as Long-Term Debt, less amounts scheduled for redemption within one year.

Component Unit Bonds. The component units of the District have each issued bonds to finance their respective projects. These bonds have limited recourse to the District. Principal and interest associated with these bonds are paid solely from the component units' revenues and receipts collected in connection with the operation of the projects. Most operating revenues earned by the component units are collected from the District in connection with the sale of gas or electricity to the District. The ability of the component units to service the debt is dependent upon the successful operation of the respective projects (see Note 6).

Callable Bonds. The District has $214.4 million of fixed rate Electric System Revenue Bonds that are currently callable and $699.8 million of bonds that become callable from 2011 through 2014. These bonds can be called until maturity. In addition, all $418.8 million of the District's Variable Rate Subordinated Bonds are currently callable.

Collateral. The principal and interest on the District's bonds are payable exclusively from, and are collateralized by a pledge of, the net revenues of the electric system of the District. Neither the credit nor the taxing power of the District is pledged to the payment of the bonds and the general fund of the District is not liable for the payment thereof.

Covenants. The District's bond resolutions contain various covenants that include requirements to maintain minimum debt service coverage ratios, certain other financial ratios, stipulated minimum funding of revenue bond reserves, and various other requirements.

NOTE 11. COMMERCIAL PAPER NOTES

The District issues Commercial Paper Notes (Notes) to finance or reimburse capital expenditures. At December 31, 2007, Notes outstanding totaled $150.0 million, and as of December 31, 2006, there were no Notes outstanding. The effective interest rate for the Notes outstanding at December 31, 2007 was 2.97 percent and the average term was 87 days. On January 23, 2007, a new $204.9 million letter of credit went into effect with fees of 0.1 percent on undrawn balances and 0.16 percent on drawn balances. There has not been a term advance under the letter of credit agreement.

The summarized activity of the District's Notes during 2007 and 2006 is presented below (thousands of dollars):

	Balance at beginning of Year	Additions	Reductions	Balance at end of Year
December 31, 2007	$ -0-	$ 150,000	$ -0-	$ 150,000
December 31, 2006	$ 200,000	$ -0-	$ 200,000	$ -0-

NOTE 12. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate the value:

Investments. The fair values of investments, including cash equivalents, are based upon quoted market prices.

Long-Term Debt. The fair value of Long-Term Debt, which includes the short-term portion, was calculated by determining the value of each individual series using a standard bond pricing formula and market yields from representative yield curves. For debt with a stepped interest rate, the fair market value of debt was calculated by discounting future interest and principal payments using a market yield from a representative yield curve. The District's electric revenue bonds, including subordinated bonds, were priced using the fair market curve for insured municipal revenue bonds. A similar fair value calculation was performed for the insured component units' bonds using the yield curve for "A" rated municipal power bonds. All yield curves were obtained from Bloomberg L.P.

Interest Rate Swap and Put Agreements. The fair values of interest rate swap and put agreements are based on quoted market prices.

Gas and Electricity Related Derivatives. The fair values of gas and electricity price swap agreements and electricity option agreements are based on forward prices from established indexes for the applicable regions. The fair values of gas and electricity purchase agreements are based on forward prices from established indexes from applicable regions and discounted using established interest rate indexes.

Market values may have changed significantly since December 31, 2007. The estimated fair values of the District's financial instruments are presented below:

	December 31, 2007	
	Recorded Value	Fair Value
	(thousands of dollars)	
Investments, including cash and cash equivalents	$ 650,364	$ 650,364
Long-term debt	(3,279,581)	(3,430,547)
Interest rate swap and put agreements	7,130	7,130
Gas and electricity related derivatives — net	75,248	75,248

	December 31, 2006	
	Recorded Value	Fair Value
	(thousands of dollars)	
Investments, including cash and cash equivalents	$ 713,361	$ 713,361
Long-term debt	(2,616,389)	(2,803,466)
Interest rate swap and put agreements	10,075	10,075
Gas and electricity related derivatives — net	25,775	25,775

NOTE 13. RANCHO SECO DECOMMISSIONING LIABILITY

Background. The Rancho Seco decommissioning liability relates to the nuclear decommissioning of the former 913 MW nuclear power plant, which terminated commercial operations in 1989. Nuclear decommissioning is the process of safely removing nuclear facilities from service and reducing residual radioactivity to a level that permits termination of the Nuclear Regulatory Commission (NRC) license, and release of the property for unrestricted use. The NRC has approved the District's decommissioning plan, which provides for removing low-level radioactive material beginning in 1997 and completing active decommissioning in 2008. The plant license will be terminated in phases. The license for the main areas of the Rancho Seco power plant site is expected to be terminated in 2008 after removal of waste, most of which is being sent to licensed disposal sites or licensed radioactive waste processors. The remaining waste will be stored on site for an unspecified period after 2008 pending availability of appropriate disposal sites. The license for the storage facilities will be terminated after the waste is removed.

The Department of Energy (DOE), under the Nuclear Waste Policy Act of 1982, is responsible for permanent disposal of spent nuclear fuel and high-level radioactive waste. The District has a contract with the DOE for the removal and disposal of spent nuclear fuel and high-level (greater than class "C": GTCC) radioactive waste. However, the date when fuel and GTCC waste removal will be complete is uncertain. The DOE has announced that it will not meet the projected optimistic opening date of 2017 for the Yucca Mountain nuclear fuel waste site and has not estimated a new estimated opening date.

The rate at which DOE will remove fuel is also uncertain. The District maintains a separately licensed on-site independent spent fuel storage facility (Storage Facility) which stores all of the District's spent fuel and GTCC waste in sealed canisters. The Storage Facility will remain under the regulation of NRC until such time as it is decommissioned after the DOE removes the nuclear fuel and GTCC radioactive waste.

Asset Retirement Obligations. These financial statements reflect the District's current estimate of its obligation for the cost of decommissioning under the requirements of SFAS No. 143 based on studies completed each year. Each year, the District evaluates the estimate of costs of decommissioning and there was no increase in cost in the 2007 study. The asset retirement obligation estimate assumes all spent nuclear fuel will be removed from the site by 2028.

Rancho Seco's asset retirement obligation is presented below (thousands of dollars):

	December 31,	
	2007	2006
Active decommissioning	$ 75,547	$ 134,620
Spent fuel management	116,197	112,859
Total ARO	$ 191,744	$ 247,479
Less: current portion	(42,292)	(54,839)
Total Non-current portion of ARO	$ 149,452	$ 192,640

The summarized activity of the Rancho Seco asset retirement obligation during 2007 and 2006 are presented below (thousands of dollars). The annual adjustments include a savings computed as the difference between the fair value of the obligation as if the decommissioning activities were performed by a third party and the amount actually incurred by the District performing the decommissioning activities.

	December 31,	
	2007	2006
ARO at beginning of year	$ 247,479	$ 284,942
Accretion	10,367	13,790
Expenditures	(55,109)	(33,398)
Annual adjustments	(10,993)	(17,855)
Total ARO	$ 191,744	$ 247,479

The District contributed $27.0 million to the Trust Fund in 2007 and 2006.

NOTE 14. PENSION PLANS

Defined Benefit Pension Plan. The District participates in the California Public Employee's Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State. Benefit provisions and all other requirements are established by State statute and District policies. The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon employee's years of credited service, age, and final compensation. Copies of PERS' annual financial report may be obtained from their Executive Office at 400 Q Street, Sacramento, California 95814.

Funding Policy. Participants are required to contribute approximately 7 percent of their annual covered salary. The District makes either the full or partial contributions required of District employees on their behalf and for their account. The District is currently required to contribute 7.4 percent of payroll to the plan. The contribution requirements of plan members and the District are established and may be amended by PERS.

Annual Pension Cost. PERS payments made by the District in 2007 were $24.8 million. The Annual Pension Cost for 2007 was $24.2 million, and $0.6 million was paid by employees for purchase of additional service credits. Overall, the District paid $23.4 million, and employees paid $1.4 million. PERS payments made by the District in 2006 were $21.6 million. The Annual Pension Cost for 2006 was $20.8 million, and $0.8 million was paid by employees for purchase of additional service credits. Overall, the District paid $20.8 million, and employees paid $0.8 million. Contributions are determined by actuarial valuations which are performed based on the entry age normal actuarial cost method. The contribution for the first half of 2007 was determined by PERS as part of the annual actuarial valuation as of June 30, 2004; the contribution for the second half of 2007 was determined by PERS as part of the annual actuarial valuation as of June 30, 2005. The actuarial assumptions included: (a) a 7.75 percent investment rate of return (net of administrative expenses), (b) projected annual salary increases that vary by duration of service, and (c) 3.0 percent per year cost-of-living adjustments. Both (a) and (b) also included an inflation component of 3.0 percent. The actuarial value of PERS' assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period (smoothed market value).

Three-year trend information for PERS is presented below (dollars in thousands):

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contribution
6/30/05	$ 8,209	100%
6/30/06	$ 20,825	100%
6/30/07	$ 24,225	100%

Funded Status and Funding Progress. As of June 30, 2006, the most recent actuarial valuation date, the plan was 99 percent funded. The actuarial accrued liability for benefits was $1,226 million, and the actuarial value of assets was $1,213 million, resulting in an unfunded actuarial accrued liability (UAAL) of $12.7 million. The covered payroll (annual payroll of active employees covered by the plan) was $163.7 million, and the ratio of the UAAL to the covered payroll was 7.8 percent.

The schedule of funding progress, presented as RSI following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Other Plans. The District provides its employees with two cash deferred compensation plans; one pursuant to Internal Revenue Code (IRC) Section 401(k) [401(k) Plan] and one pursuant to IRC Section 457 (457 Plan) (collectively, the Plans). The Plans are contributory plans in which the District's employees contribute the funds. Each of the District's eligible full-time or permanent part-time employees may participate in either or both Plans, and amounts contributed are vested immediately. Such funds are held by a Trustee in trust for the employees upon retirement from District service and, accordingly, are not subject to the general claims of the District's creditors. The District is responsible for ensuring compliance with IRC requirements concerning the Plans and has the duty of reasonable care in the selection of investment alternatives, but neither the District, nor its Board or officers have any liability for market variations in the Plans' asset values. District employees are responsible for determining how their funds are to be invested and pay all ongoing fees related to the Plans. The Plans are currently not subject to discrimination testing, nor the requirements of the Employee Retirement Income Security Act of 1974. The District employees participating in the Plans are allowed to contribute a portion of their gross income not to exceed the annual dollar limits prescribed by the IRC.

The District makes annual contributions to the 401(k) Plan on behalf of certain employees pursuant to a memorandum of understanding with both of its collective bargaining units. The District does not match employee contributions, nor make contributions on behalf of its employees to the 457 Plan. Participating employees and the District made contributions into the Plans totaling $15.9 million and $1.5 million in 2007, respectively, and $15.5 million and $0.8 million in 2006, respectively.

NOTE 15. OTHER POSTEMPLOYMENT BENEFITS

The District provides postemployment healthcare benefits, in accordance with District policy and negotiated agreements with employee representation groups in a single employer defined benefit plan, to all employees who retire from the District, and their dependents, on or after attaining age 50 with at least 5 years of service. The District also provides postemployment healthcare benefits to covered employees who are eligible for disability retirement. The District contributes the full cost of coverage for employees hired before January 1, 1991, and a portion of the cost based on credited years of service for employees hired after January 1, 1991. The District also contributes a portion of the costs of coverage for these employees' dependents. Plan members are required to contribute the portion that is not paid by the District. The benefits, benefit levels, employee contributions and employer contributions are governed by the District and can be amended by the District through its personnel manual and union contracts. At December 31, 2007, 2,466 postemployment participants, including retirees, spouses of retirees, surviving spouses, and eligible dependents, participated in the District's healthcare benefits program.

In June 2004, GASB issued GASB No. 45, which establishes standards of accounting and financial reporting for OPEB expense and related OPEB liabilities or assets. OPEB arises from an exchange of salaries and benefits for employee services rendered, and refers to postemployment benefits other than pension benefits such as post employment healthcare benefits. The District considers the following benefits to be OPEB: Medical, Dental and Long-Term Disability. This Statement is effective for the District beginning in 2007 and the District has implemented GASB No. 45 prospectively.

GASB 45 states that funding of a plan occurs when the following events take place: the employer makes payments of benefits directly to or on behalf of a retiree or beneficiary, the employer makes premium payments to an insurer, or the employer irrevocably transfers assets to a trust or other third party acting in the role of trustee for the sole purpose of the payments of the plan benefits, and creditors of the government do not have access to those assets.

Funding Policy. During 2007 and 2006, the District recorded postemployment health care benefit contributions based on when the payment was made. During 2007 and 2006, postemployment health care benefit contributions were $9.8 million and $11.5 million, respectively. As of December 31, 2007, the District had not established an irrevocable trust or designated a trustee for the payment of plan benefits. As such, there is no separately issued report of the plan. The funding policy is currently pay-as-you-go.

Funding Status and Funding Progress. At December 31, 2007 and 2006, the District estimates that the actuarially determined accumulated postemployment benefit obligation was approximately $248.7 million and $262.5 million, respectively. There were no assets as of that date, thus the entire amount is unfunded.

The District contracted with PERS to administer OPEB benefits effective January 18, 2008 and made a deposit on February 1, 2008 for the net Annual Required Contribution (ARC) for 2007 and 2008. See Note 19.

The covered payroll (annual payroll of active employees covered by the plan) is $192.0 million. The ratio of the unfunded actuarially accrued liabilities (UAAL) to covered payroll is 130 percent.

Annual OPEB Cost. The annual OPEB cost (expense) is calculated based on the ARC of the employer, an amount actuarially determined in accordance with the parameters of GASB 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. For 2007, the District's annual OPEB Cost (expense) of $23.7 million was equal to the ARC. The payment of current health insurance premiums, which totaled $9.8 million for retirees and their beneficiaries resulted in a Net OPEB obligation of $13.9 million for the year ended December 31, 2007.

The following table shows the components of the Districts annual OPEB cost for the year, the amount actually paid in premiums, and changes in the net OPEB obligation:

	Year Ended December 31, 2007
Annual required contribution	$ 23,695
Interest on net OPEB obligation	-0-
Adjustment to annual required contribution	-0-
Annual OPEB cost (expense)	23,695
Contributions made	9,830
Increase in net OPEB obligation	13,865
Net OPEB obligation, beginning of year	-0-
Net OPEB obligation, end of year	13,865

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2007 is as follows:

Year Ending	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
December 31, 2007	$23,695	41%	13,865

Actuarial Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing the benefit costs between the employer and 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 actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The entry age normal was used in the December 31, 2007 actuarial valuation. Actuarial assumptions used a 7.75 percent investment rate of return (net of administrative expenses), and a 3.25 percent inflation assumption. This was a new method required for entry into PERS California Employers' Retiree Benefit Trust (CERBT). For the December 31, 2006 calculation, the projected unit cost method was used, with an actuarial assumption of a 7.1 percent investment rate of return (net of administrative expenses), and a 3 percent inflation assumption. For both years, the actuarial assumptions for an annual healthcare cost trend growth of 12 percent for the current year and declining 1 percent per year until 5 percent is reached. The 5 percent growth is used on a go forward basis. The UAAL will be amortized as a percentage of payroll over an open 30-year period. The actuarial value of assets was not determined as the District has not advance funded its obligation.

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 ARC of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

NOTE 16. INSURANCE PROGRAMS AND CLAIMS

The District is exposed to various risks of loss related to torts, theft of and destruction to assets, errors and omissions, and natural disasters. In addition, the District is exposed to risks of loss due to injuries to, and illnesses of, its employees. The District carries commercial insurance coverage to cover most claims in excess of specific dollar thresholds, which range from $0.1 million to $2.5 million per claim with total excess liability insurance coverage for most claims of $100.0 million. District property insurance coverage is based on the replacement value of the asset. There have been no significant reductions in insurance coverage in 2007. In 2007, 2006 and 2005, the insurance policies in effect have adequately covered all settlements of the claims against the District. No claims have exceeded the limits of property or liability insurance in any of the past three years. In 2006, earthquake and terrorism insurance limits decreased from the 2005 limits, but no other property and related insurance limits had significant reductions in coverage compared to the prior year. The claims liability is included as a component of Self Insurance, Deferred Credits and Other in the Consolidated Balance Sheets.

The District's total claims liability, comprising claims received and claims incurred but not reported, at December 31, 2007, 2006, and 2005 is presented below:

	2007	2006 (thousands of dollars)	2005
Workers' compensation claims	$ 6,434	$ 5,862	$ 4,741
General and auto claims	1,410	2,004	2,940
Short- and long-term disability claims	1,621	1,247	1,691
Claims liability	$ 9,465	$ 9,113	$ 9,372

Changes in the District's total claims liability during 2007, 2006 and 2005 is presented below:

	2007	2006 (thousands of dollars)	2005
Claims liability, beginning of year	$ 9,113	$ 9,372	$ 11,999
Add: provision for claims, current year	2,123	2,180	3,690
Increase/(Decrease) in provision for claims in prior years	2,264	2,032	(882)
Less: payments on claims attributable to current & prior years	(4,035)	(4,471)	(5,435)
Claims liability, end of year	$ 9,465	$ 9,113	$ 9,372

NOTE 17. COMMITMENTS

Electric Power Purchase Agreements. The District has numerous power purchase agreements with other power producers to purchase capacity and associated energy to supply a portion of its load requirements. The District has minimum take-or-pay commitments for energy on most contracts. Certain contracts allow the District to exchange energy, received primarily in the summer months, when the District most needs the energy and to return energy during the winter months, or other subsequent periods.

At December 31, 2007, the approximate minimum obligations for these contracts over the next five years are as follows:

Year ending:	Amount (thousands of dollars)
2008	$ 203,180
2009	195,232
2010	169,898
2011	133,000
2012	108,474

Contractual Commitments beyond 2012. Several of the District's purchase power contracts extend beyond the five-year summary presented above. These contracts expire between 2013 and 2026 and provide for power under various terms and conditions. The District estimates its annual minimum commitments under these contracts range between $95.1 million in 2013 and $0.7 million in 2026. The District's largest purchase power source is the Western Area Power Administration (Western) Base Resource contract, whereby the District receives 31.25 percent of the amount of energy made available by Western, after meeting Central Valley Project (CVP) use requirements, in any given year at a 31.25 percent share of their revenue requirement. On January 1, 2015, the District's percentage share changes to approximately 25 percent. The Western contract expires on December 31, 2024.

Electric Power Price Swap Agreements. The District has entered into numerous variable to fixed rate swaps with notional amounts totaling 1,315,800 megawatt hours (MWh) for the purpose of fixing the rate on the District's electric power purchases. These electric power price swap agreements result in the District paying fixed rates ranging from $52.20 to $66.45 per MWh. The swap agreements expire periodically from January 2008 through December 2009.

Gas Supply Agreements. The District has numerous long-term natural gas supply agreements with Canadian and U.S. companies to supply a portion of the consumption needs of the District's natural gas-fired power plants, which expire through 2015.

Gas Transport Capacity Agreements. The District has numerous long-term natural gas transport capacity agreements with Canadian and U.S. companies to transport natural gas to the District's natural gas-fired power plants from the supply basins in Alberta to the California-Oregon border and from supply basins in the southwest and Rocky Mountains to the Southern California border. These gas transport capacity agreements provide for the delivery of gas into District-owned pipeline capacity within California. The gas transport capacity agreements provide the District with 64,000 dekatherms (Dth) per day (Dth/d) of natural gas pipeline capacity to the Canadian Basins through 2023 and 66,000 Dth/d to the Southwest or Rocky Mountain Basins through at least 2018.

Gas Storage Agreements. The District also has an agreement for the storage of up to 2.25 million Dth of natural gas at a regional facility. The gas storage agreement expires in 2009.

At December 31, 2007, the approximate minimum obligations for these natural gas related contracts over the next five years are as follows:

Year ending:	Amount (thousands of dollars)
2008	$ 79,983
2009	266,652
2010	230,773
2011	222,812
2012	220,962

Contractual Commitments beyond 2012. Several of the District's gas transport and gas storage contracts extend beyond the five-year summary presented above. These contracts expire between 2013 and 2023 and provide for transportation and storage under various terms and conditions. The District estimates its annual minimum commitments under these contracts to be between $221.0 million in 2013 and $5.0 million in 2023.

Gas Price Swap Agreements. The District has entered into numerous variable to fixed rate swaps with notional amounts totaling 175,030,000 million British Thermal Units (mmbtu) for the purpose of fixing the rate on the District's natural gas purchases for its gas-fueled power plants and gas indexed electric contracts. These gas price swap agreements result in the District paying fixed rates ranging from $4.63 to $9.64 per mmbtu. The swap agreements expire periodically from January 2008 through December 2022.

NOTE 18. CLAIMS AND CONTINGENCIES

U.S. Bureau of Reclamation Water Service Contract Billing Dispute. The District entered into a 40-year water service contract with the Bureau, which expires in 2012, for the delivery of up to 75,000 acre-feet of water per year to originally meet the District's needs at Rancho Seco. This amount includes 60,000 acre-feet of municipal and industrial (M&I) water from the CVP. Over time, Bureau revenues have been insufficient to cover actual CVP operations and maintenance (O&M) costs; CVP contractor payments have been insufficient to cover amortization of their respective shares of CVP capital costs and, in the case of M&I contractors, have been insufficient to cover interest on unpaid capital. Although the District's contract contains a specific rate methodology, the Bureau maintained that the District and other M&I contractors are running substantial O&M deficits which, by the Bureau's definition, includes as O&M costs both unpaid interest on capital and interest on the O&M deficit. The District, in concert with the M&I contractors, filed their complaint against the Bureau in March 2003 in the U.S. District Court. Under the guidance of a federal magistrate, negotiations were held and a settlement was reached with the Department of the Interior in March 2005.

In general, the settlement reduces each contractor's obligation based on a combination of lower interest rates and simple interest; and the contractors commit to repayment of under-recovered capital and O&M costs. The contractors can either pay off the obligation or retire it in rates. In December 2004, the Board approved the settlement and deferred the obligation as a Regulatory item (see Note 8) to be recovered in future rates as the obligation is repaid to the Bureau. This amount is included in Due to U.S. Bureau of Reclamation in the balance sheet. In July 2006, the District entered into an agreement with the Sacramento County Water Agency (SCWA) to assign 30,000 acre feet of CVP water. SCWA paid the District $3.0 million and SCWA agrees to pay one half of the District's M&I deficit at September 30, 2006. The District estimates that its obligation is $6.2 million and $5.8 million at December 31, 2007 and 2006.

California Energy Market Refund Dispute. In 2001, the FERC issued an order establishing evidentiary hearings for the purpose of determining the amount of refunds, if any, due to customers of the California Independent System Operator (ISO) and California Power Exchange (PX) spot markets from market participants selling into those markets for the period October 2, 2000 through June 20, 2001. During this time period, the District was both a seller and a buyer in the California spot markets. This matter has been the subject of various proceedings with the FERC and court filings with the U.S. Court of Appeals for the Ninth Circuit (Ninth Circuit) since 2001.

In July 2001, the FERC issued an order asserting refund authority over municipal entities, including the District. The District filed a request for rehearing of the order on the grounds that the FERC exceeded its jurisdiction by seeking to impose refund authority over non-jurisdictional utilities. In January 2002, the District filed a Petition for review of the FERC's orders with the Ninth Circuit, arguing among other things that the FERC lacks the authority under the Federal Power Act to assess refund liability against non-jurisdictional entities. The Ninth Circuit divided the pending appeals into two phases. Phase 1 addressed the question of jurisdiction and Phase 2 addressed the scope of the refund period and the types of transactions subject to refund.

On September 6, 2005, the Ninth Circuit issued its Phase 1 opinion finding that the FERC does not have refund authority over wholesale power sales made by governmental entities and other non-public utilities, including the District. On August 2, 2006, the Ninth Circuit issued its Phase 2 decision on the scope/transaction issues. Of particular significance to the District, the Ninth Circuit upheld the FERC's decision that bilateral transactions between the California Energy Resource Scheduler (CERS) and other entities that occurred outside of the ISO and PX markets should not be mitigated. Other conclusions reached by the Court include: (1) the FERC properly established October 2, 2000 as the refund effective date for the Section 206 proceeding; (2) the FERC erred in excluding Section 309 relief for tariff violations that occurred prior to October 2, 2000; (3) the FERC erred in limiting refund liability to spot market sales i.e. the 24-hour sales period, as opposed to forward sales (day-ahead, multi-day sales, etc.) in the ISO and PX markets; and (4) the FERC erred in excluding energy exchange transactions in the ISO and PX markets. The likely result of the Court's expansion of the refund proceedings is that the District will receive a greater amount of refunds for purchases made during this timeframe. It remains unclear, however, whether this decision will necessarily result in an indefinite delay in the refund calculations currently ongoing at the FERC.

On October 19, 2007, the FERC issued an Order on Remand in compliance with the September 6, 2005 by the Ninth Circuit. In this order, the FERC vacates each of its California Refund orders to the extent they subject non-public utility sellers to the FERC's section 206 refund authority. Accordingly, the FERC requires the ISO and the PX to refund the approximately $18 million in principal amounts of receivables for sales by the District, plus the District's collateral held by the PX. The

District will also receive an unknown amount of refunds for the purchases from the ISO and PX markets plus interest. Rehearing requests on the FERC's order of remand were due by November 19, 2007. On December 10, 2007, the Supreme Court of the United States denied the writ of cert previously filed by PG&E. Accordingly, the Ninth Circuits' finding that the FERC did not have refund jurisdiction over municipal utilities for sales made during the California energy crisis is now final. As the Ninth Circuit decision stands, the District has no refund liability. The District had not accrued any liability in this matter.

Replacement Reserves Dispute. In August 2003, PG&E issued invoices totaling $2.2 million for replacement reserve charges purportedly incurred by PG&E for energy scheduled through its Rancho Seco intertie point from July 2000 through June 2002. In September 2003, the District provided PG&E notice of dispute of the invoices due to the fact that the billing was inconsistent with the Restated Interim Agreement, the primary agreement between the parties governing such transactions and, therefore, there should never have been any Replacement Reserve charges incurred in connection with the power deliveries at issue. PG&E functioned as the Scheduling Coordinator on the District's behalf for transactions with the ISO at this intertie point until June 2002, when the District became its own control area. These Replacement Reserve charges purportedly relate to power purchased by the ISO to cover deviations between actual load and forecasted load. The District believes that, even if the charges were appropriate, PG&E's delay in billing within a reasonable timeframe compromised the District's ability to modify its operations or scheduling procedures to eliminate or mitigate the charges. In October 2003 the District and PG&E entered into a tolling agreement, which among other things, tolls any applicable statute of limitations and may be terminated by either party upon thirty days written notice. District management believes that it is likely that it will not be found liable for any charges in this matter, and therefore no liability has been recorded.

COTP II Arbitration. The ISO filed to pass through charges on transactions involving the COTP, the District and Western control area. The ISO is seeking to pass through $9.0 million in new charges to PG&E as the COTP's and Western's control areas proxy scheduling coordinator. These charges include emissions costs, start-up costs, and minimum load costs (Must Offer costs). PG&E disputes the ISO's authority to impose any charges on it as the Scheduling Coordinator for COTP and filed for arbitration in July 2004. The District filed its intervention in the arbitration in July 2004.

Arbitration hearings were conducted in July 2005. In September 2005, the arbitrator issued an award finding that the ISO improperly assessed PG&E the Must Offer Costs related to the COTP and related transactions involving municipal utilities within California. Accordingly, the arbitrator ordered the ISO to adjust the billings to reflect a full refund of all Must Offer Costs for transactions on the COTP and Western transactions through the close of the record. However, the arbitrator's order did not award PG&E interest on the refunded amount based on his belief that PG&E did not request interest. In October 2005, the ISO filed a petition for review of the arbitrator's award with the FERC. PG&E filed a petition for review on that same day raising as its sole issue the arbitrator's failure to provide PG&E with interest on the refunded amount. In November 2005, the District and the other Joint Interveners filed a motion to intervene, motion to reject the ISO's petition for review, and, in the alternative, motion to consolidate PG&E's petition for review with that of the ISO's. On January 12, 2006, the FERC issued an order denying the motion to reject, consolidating the proceedings, and establishing a procedural schedule. The parties completed briefing in April 2006 and are awaiting the commission's decision.

The District believes that the ISO will not prevail in its attempts to pass charges through to the COTP and the District and the Western control area. The District believes that previous COTP arbitration and subsequent FERC orders confirmed that such a pass through was in violation of the ISO Tariff. Should the ISO ultimately prevail, the District estimates that its share of the $14.0 million that the ISO seeks to charge may be as much as $3.0 million. The District believes that it will prevail in this matter and, therefore, no liability has been recorded at December 31, 2007.

Claims for 2000 and 2001 Power Sales. On December 6, 2005, Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company and the Electricity Oversight Board (collectively, the California Parties) filed a claim for damages pursuant to California Government Code § 910.4 (Tort Claims Act) and in March 2006 filed complaints against the District and other governmental entities (Governmental Entities) for damages and/or restitution and declaratory relief in Federal District Court in the eastern District of California. The California Parties' claim arises from the District's power sales from May 1, 2000 through June 20, 2001 in the wholesale electricity markets operated by the ISO and the PX under tariffs filed with the FERC. The California Parties allege that the District is contractually obligated under the PX Participation Agreement to reimburse the California Parties for any amounts that the FERC might find were unjust under the California Refund Proceedings. In March 2007, the federal court dismissed the complaints for lack of subject matter jurisdiction. The California Parties appealed the judge's decision in the Ninth Circuit. In April 2007, the California Parties filed a breach of contract claim in Los Angeles Superior Court against the Governmental Entities, who filed demurrers on August 24, 2007, which were denied on December 4, 2007. The Governmental Entities filed a petition for writ of mandate in mid-January 2008 with respect to the statute of limitation defense. In this state court action, the California Parties are seeking damages from the Governmental Entities in the amount that the Entities would have been required to refund to the California market had the Governmental Entities been subject to refund authority at the FERC. The complaints allege that the Governmental Entities are contractually obligated to reimburse the California Parties for the difference between the rates paid to the Governmental Entities for sales into the ISO/PX markets during the Refund Period and the mitigated rates as determined by FERC.

Although the California Parties' claim and complaint does not specify the amount of damages that the California Parties seek, the District expects that this amount would parallel the refund that the District would owe to the market if it were subject to refund liability. Accordingly, the District estimates that its potential refund liability ranges between no liability and approximately $14.0 million plus interest. Ultimately, the District does not believe that the California Parties will be successful in pursuing the claim.

On January 3, 2006, the Attorney General of the State of California and the California Department of Water Resources (collectively, the State Entities) filed a claim for damages pursuant to the Tort Claims Act. The State Entities' claim arises out of the District's power sales into the ISO/ PX markets from May 1, 2000 through June 20, 2001, as well as the District's bilateral power sales to the Department of Water Resources (DWR) through the CERS. The District returned the claim as untimely in mid-January 2006.

On June 14, 2006, the State Entities filed a complaint for damages in the Sacramento Superior Court of California. Similar to the California Parties' claim, discussed above, the State Entities allege that the District is contractually obligated under the PX Participation Agreement to reimburse the State Entities for any amounts that the FERC might find were unjust under the California Refund Proceedings. With respect to the District's bilateral sales to CERS, the State Entities claim that the District is contractually obligated to reimburse the State Entities for the difference between the rates received for any sales made under the Western Systems Power Pool (WSPP) Agreement and a lawful rate as determined by the FERC.

The District believes that the claim is untimely filed under the one-year statute of limitations under the Tort Claims Act, if applicable, and the four-year statute of limitations for contract claims. With respect to the District's bilateral sales to the DWR, the FERC has already refused to mitigate bilateral power sales to CERS, which has been upheld by the Ninth Circuit. In addition, the Ninth Circuit's recent decision that the FERC lacks refund authority over wholesale power sales made by governmental entities, like the District, imposes further obstacles that the State Entities must overcome to prevail in litigation. On December 19, 2006, the State Entities filed a request for dismissal without prejudice with respect to the cause of action and related allegations that pertain to the bilateral purchases of energy by DWR.

On January 11, 2007, the State Entities filed its amended complaint and served it on the District on January 18, 2007. The amended complaint, similar to the original complaint, attempts to recover damages for breach of contract, unjust enrichment, and money received. It further states that it arises out of the District's voluntary power sales to DWR and the ISO, for which DWR paid, from May 1, 2000 through June 20, 2001. The complaint further provides that the sales transactions occurred in wholesale markets governed by the ISO and PX and the tariffs those entities filed with the FERC. Significantly, the amended complaint does not state that it seeks recovery for the District's bilateral sales to CERS that were made pursuant to the WSPP Agreement. The amended complaint suggests, however, that DWR intends to recover those monies by now characterizing those sales as having been made pursuant to the ISO Tariff. On February 23, 2007, the District entered into a tolling agreement with the State Entities, under which the State Entities agreed to dismiss without prejudice its claim against the District on or before March 1, 2007. The tolling agreement serves to put a temporary hold on all future action in the State Entities' prosecution of its lawsuits, and in any lawsuit the District may bring against the State Entities, until the parties have a better understanding of the progress of other related proceedings.

Similar to the California Parties', the State Entities seek the difference between the market price paid to the District and the FERC-mitigated price. Accordingly, the District estimates that its liability for these market sales ranges between no liability and $13.5 million. Further, while the State Entities do not specify the amount of damages that they seek for the sales, the District estimates that this amount is approximately $72.0 million based on the FERC-mitigated price as of

July 2004. Ultimately, the District does not believe that either party will be successful in pursuing the claims. Consequently, District management believes that the outcome of these matters will not have a material adverse impact on the District's financial position or results of operations.

Fru-Con Construction Corporation Construction Matters. In August 2003, the District entered into a contract with Fru-Con Construction Corporation (Fru-Con) to construct the District's 500 MW CPP Project. St. Paul Travelers Casualty Company (Travelers) is obligated, under a Performance Bond, to guarantee Fru-Con's performance under the contract. The original construction schedule for the CPP Project called for commercial operation in September 2005. The CPP Project became operational on February 24, 2006.

Though Fru-Con has previously made claims for comparably smaller amounts that have been resolved through negotiation, in October 2004, Fru-Con asserted additional claims totaling $26.0 million. Beginning in October 2004 and continuing until early February 2005, the District and Fru-Con participated in negotiations to resolve disputes over both cost and delays in the CPP Project schedule. The parties were unable to resolve the disputes to the satisfaction of the District and in February 2005, the District terminated its contract with Fru-Con on the basis of breach of contract by Fru-Con. On February 28, 2005, the District filed suit in the Sacramento County Superior Court against Fru-Con and one of its sub-contractors alleging breach of contract and violation of the California False Claims Act.

On March 24, 2005, Fru-Con filed its complaint against the District in Federal Court, alleging breach of contract. Then, on March 29, 2005, Fru-Con attempted to remove the State Court Action to federal court. On May 23, 2005, the federal court granted the District's motion to remand, and transferred the State Court Action back to the Sacramento County Superior Court. On August 10, 2005, the federal court denied without prejudice the District's motion to stay the Federal Court Action. Upon remand to state court, Fru-Con moved to stay the State Court Action in favor of its later-filed federal court action. On August 19, 2005, the Superior Court denied Fru-Con's motion to stay the State Court Action. Both parties have filed estimates of damages, with the District estimating its claims at $60.0 million or more. Fru-Con estimates that its claims will be more than $20.0 million, plus fees.

Since January 2005, the District has also been pursuing a claim against Travelers under the performance bond. On September 28, 2005, Travelers denied the District's claim and filed a declaratory relief action in the same federal court as the Fru-Con Federal Court Action. The District filed a counterclaim in response to Travelers' lawsuit. In general, the District is seeking to recover from Travelers all of the damages it claims against Fru-Con plus attorneys' fees related to the Traveler's suit.

Discovery took place in 2006 and 2007. In June 2007, the Sacramento County Superior Court issued a summary adjudication order upholding SMUD's right to terminate the contract, leaving for trial only the issue of the amount of damages owed by Fru-Con to the District. Fru-Con appealed the Superior Court order, but on September 25, 2007, the California Supreme Court denied the appeal. The trial is now scheduled to start in Superior Court in April 2008.

In Federal District Court, a hearing was held in January 2008 on the District's and Travelers motions for summary judgment; the parties are awaiting a decision. At this time, no federal trial date has been set.

District management believes it is reasonably likely to be successful in refuting, at a minimum, a majority of Fru-Con's claims and it is reasonably likely to prevail in a majority of its claims against Fru- Con and Travelers. District management also believes that the outcome of this matter will not have a material adverse impact on the District's financial position or results of operations. No liability or receivable has been recorded by the District in connection with these disputes.

Other Construction Matters. The District contracts with various other firms to design and construct facilities for the District. Currently, the District is party to various claims, legal actions and complaints on some of these construction projects. District management believes that it will be successful in refuting these allegations, and estimates that the ultimate resolution of these matters will not have a material adverse effect on the District's financial position or results of operations.

Environmental Matters. The District is one of many potentially responsible parties that have been named in a number of actions relating to environmental claims and/or complaints. Due to the nature of these claims, legal actions or complaints, the District is unable to predict the range of costs for resolution of these actions and intends to take all actions necessary to defend its position. Some of these matters name the District along with other electric utilities as potentially responsible parties.

The District has estimated its exposure to such costs based on its proportionate share of the potential claim and recorded its share as a liability; in most instances this is a relatively small percentage. However, should other named responsible parties become insolvent and unable to pay their share of the claims, the District's share of these contingent liabilities would increase and could be material. District management does not believe this will occur, and accordingly, management believes that the outcome of these environmental claims will not have a material adverse impact on the District's financial position or results of operations.

Other Matters. In the normal operation of business, the District is party to various claims, legal actions and complaints. Management and the District's legal counsel believe that there are no other material loss contingencies that would have a material adverse impact on the District's financial position or results of operations.

NOTE 19. SUBSEQUENT EVENT

In October 2007, the Governor signed Assembly Bill 554 (AB 554) into law. AB 554 allows California public employers to join the CERBT to prefund their OPEB obligations after January 1, 2008. On December 6, 2007 the Board approved a participation agreement with PERS for PERS to be the plan administrator for the District's OPEB trust. The participation agreement was submitted to PERS on January 16, 2008 and became effective on January 18, 2008. On February 1, 2008, the District contributed $22.9 million to the PERS CERBT fund.

Plan Description. The plan is CERBT Fund, which is an IRC Section 115 Trust set up for the purpose of receiving employer contributions to prefund health and other postemployment benefits for retirees and their beneficiaries. The plan is an agent multiple employer plan and will be administered by PERS. It will provide medical, dental and long term disability benefits for retirees and their beneficiaries. Any changes to these benefits would be approved by the District's Board and union contracts. To obtain a CERBT report, please contact PERS at 888-CALPERS.

REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

Schedules of Funding Progress

PERS Pension. The schedule of funding progress for PERS is presented below for the three most recent years for which the District has available data (dollars in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) — Entry Age (b)	Unfunded AAL (UAAL) (Excess of Assets over AAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL (Excess of Assets over AAL) as a Percentage of Covered Payroll ((b-a)/c)
6/30/04	$ 1,087,532	$ 1,054,410	$ (33,122)	103.1%	$ 155,289	(21.3%)
6/30/05	$ 1,143,666	$ 1,141,187	$ (2,478)	100.2%	$ 158,557	(1.6%)
6/30/06	$ 1,213,295	$ 1,226,029	$ 12,734	99.0%	$ 163,744	7.8%

OPEB. The schedule of funding progress for the other post-employment benefit health care plan is presented below for the two most recent years for which the District has available data (dollars in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) — Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
1/1/2008	$ -0-	$ 248,691	$ 248,691	0%	$ 192,045	130%
1/1/2007	$ -0-	$ 262,546	$ 262,546	0%	$ 186,000	141%

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