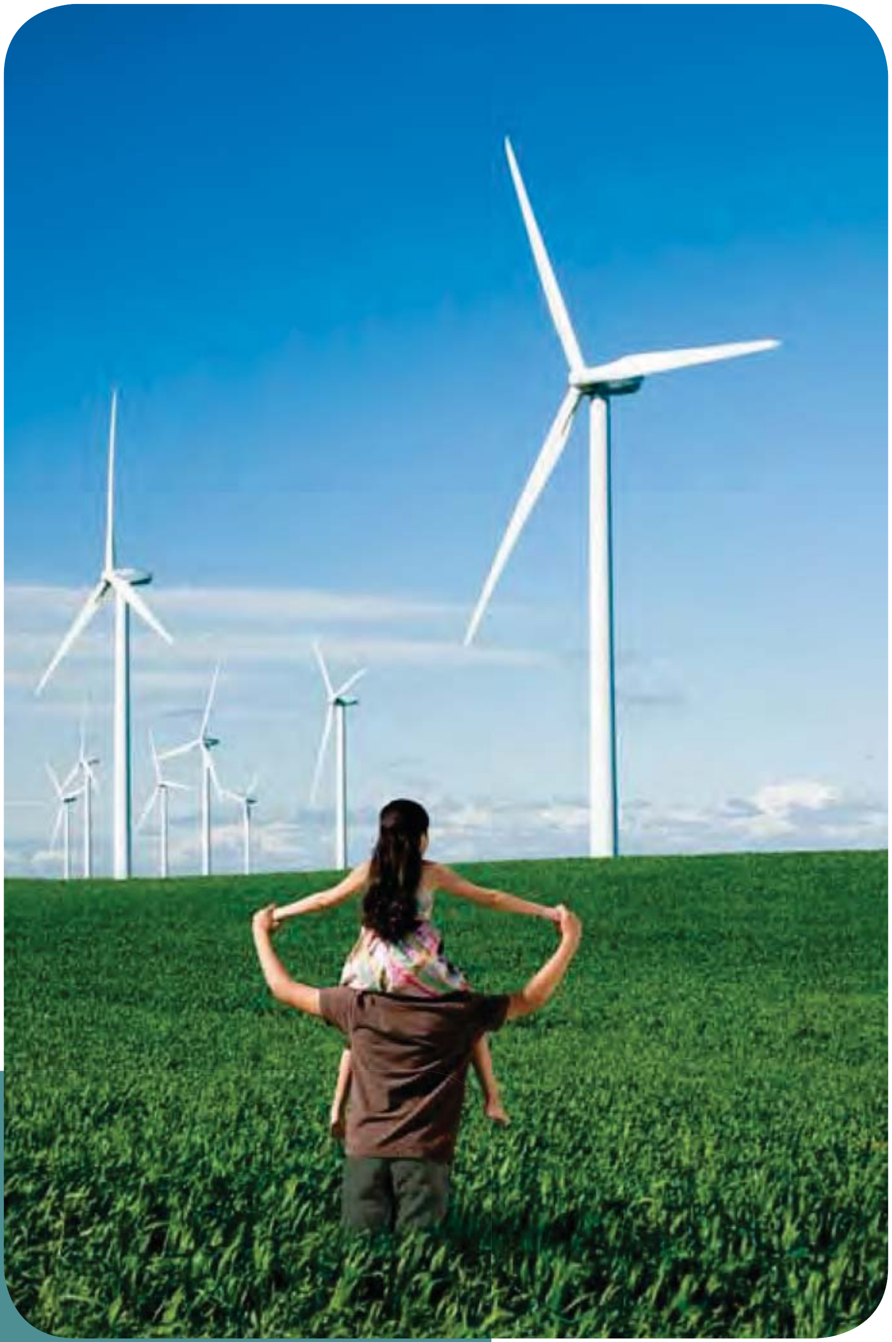
SACRAMENTO MUNICIPAL UTILITY DISTRICT



Beyond Carbon

2008 Annual Report

SMUD Overview 2008

Service Area Population
1.4 million

Record Peak Demand
3,299 megawatts
on July 24, 2006

Total Operating Revenue
$1.5 billion

Number of Customers (year end)
592,490

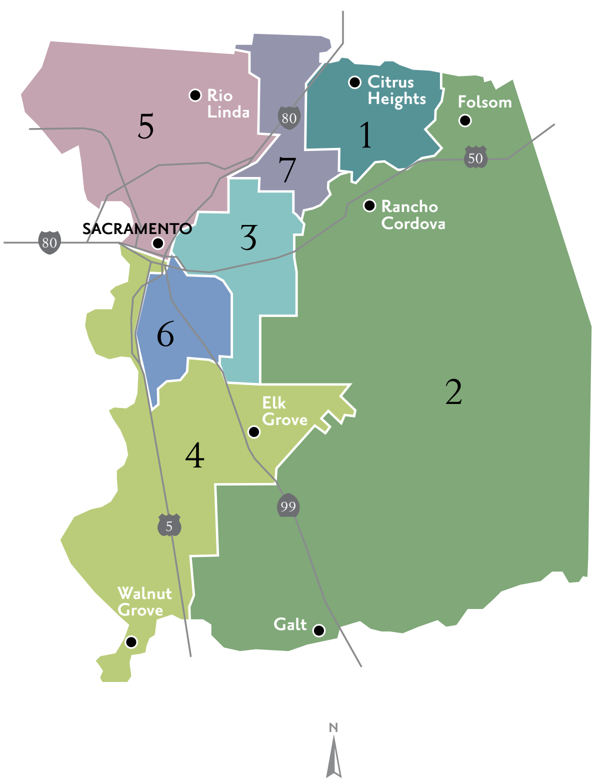
Employees (year end)
2,197

Credit Rating

A+	Standard & Poor's
A1	Moody's
A	Fitch

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 selected 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.



Board of Directors

Renee Taylor
Ward 1

Nancy Bui
Ward 2

Howard Posner
Ward 3
President 2009
Vice President 2008

Genevieve Shiroma
Ward 4

Rob Kerth
Ward 5

Larry Carr
Ward 6

Bill Slaton
Ward 7
Vice President 2009

Executive Management

John DiStasio
General Manager and
Chief Executive Officer

Betty Masuoka
Assistant General Manager,
Distribution & Operations

James R. Shetler
Assistant General Manager,
Energy Supply

Arlen Orchard
General Counsel

James A. Tracy
Chief Financial Officer and
Director of Business Planning & Budget

Elisabeth Brinton
Director, Communications
& Community Relations

Linda Carey Johnson
Chief Information Officer and
Director of Business Technology

Mike Gianunzio
Director, Legislative & Regulatory

Gary King
Director, Workforce Management

Paul Lau
Deputy Assistant General Manager,
Customer, Distribution & Operations

Cary M. Nethaway
Controller

Noreen Roche-Carter
Treasurer

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Produced by Communications & Community Relations

General Manager's Letter

John DiStasio
CEO/General Manager

These are some of the most challenging times SMUD has faced in 60-plus years of service. At the same time, difficult times present opportunities for leadership and service. SMUD's core mission is to deliver vital energy reliably and affordably. We also recognize that bold action is required to continue this mission and ensure a cleaner, more environmentally sustainable future for our customers and community *—a future beyond carbon.*

SMUD has long been a leader in energy efficiency and renewable energy, placing us front and center in today's national energy discussion. From Washington D.C. to Seattle, SMUD is respected as one of the most progressive utilities in the nation. We're demonstrating that it's possible to deliver non-polluting, renewable energy at an affordable rate without compromising reliability. SMUD built the first utility-scale solar facility in the mid-1980s. We're on track to become the first California utility to receive 20 percent of its energy from renewable resources. Just this past year, SMUD started SolarShares, a landmark program that offers solar power to all customers.

In 2008, SMUD ranked first among California electric utilities for the seventh straight year in a survey of residential customers. To expand our renewable portfolio, we purchased the entire output of a 55-megawatt biomass cogeneration plant in Tacoma, Wash. We contracted with local builders to construct more than 4,000 new solar homes.

In 2008, SMUD ranked first among California electric utilities for the seventh straight year in a survey of residential customers.

SMUD's Upper American River Project provides clean hydroelectricity to the Sacramento region.

At SMUD's Youth Energy Summit, local high school students learned about many facets of the energy industry, including electric transportation.

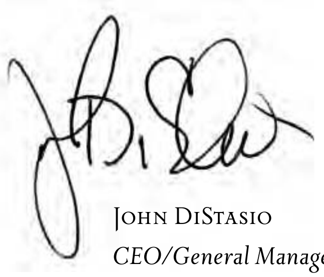
SMUD completed work on a solar-powered hydrogen fuel cell station. Our aggressive R&D group continues to evaluate, test and commercialize new technologies that allow customers to use energy more efficiently, such as LED sensors in supermarket freezers that will save grocers — and ultimately customers — money.

SMUD plans to exceed California's stringent energy efficiency mandates by 50 percent over the next 10 years. We're investing in new technologies that will give customers real-time usage information to help them manage their bills and energy consumption. Our customers count on us to keep their lights on, but they also expect us to balance the challenges of delivering new types of energy while keeping monthly bills as low as possible. Quality of life, personal comfort and commercial viability for local businesses mean different things to different people — one approach on energy usage does not fit all. SMUD takes these responsibilities seriously and is committed to a future that is sustainable and prosperous.

SMUD plans to exceed California's stringent energy efficiency mandates by 50 percent over the next 10 years.

On a more personal note, I was appointed SMUD's CEO and general manager in June by our Board of Directors. I've been working at SMUD for nearly 28 years, the last eight as assistant general manager for Energy Delivery and Customer Service. For someone whose family has called Sacramento home for 100 years, I'm honored to lead a local organization that has such a positive impact on the lives of residents and businesses throughout the region during such an important time.

Please take a few moments to read about some of the ways SMUD is making a difference.



John DiStasio
CEO/General Manager

A Challenging Year

Providing electricity to 592,000 customers on a daily basis presents no shortage of challenges. That was particularly true for SMUD in 2008, when a severe economic downturn struck the Sacramento region. The resulting slowdown in requests for new electric service was the worst on record, and disruptions in the municipal bond markets made routine funding for operations a challenge.

SMUD responded early in the year by trimming its operating budgets and re-evaluating all of its planned capital projects. In addition, several strategic and operational decisions paid one-time dividends in 2008.

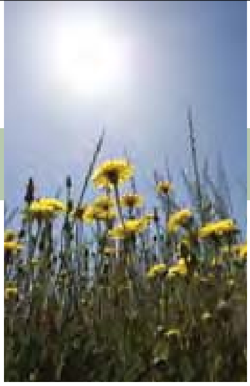
Litigation with gas companies for price manipulation during the energy crisis brought SMUD $10 million in 2008. SMUD also completed the multi-year radiological decommissioning of the Rancho Seco nuclear plant. Decommissioning was completed on schedule and came in millions of dollars under budget. As a result, SMUD finished 2008 in relatively solid shape, with $22 million in net income. But that result was achieved in part through one-time windfalls.

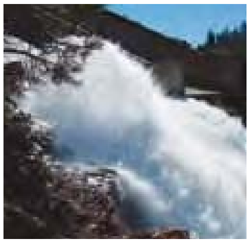
The SMUD Board also approved self-insurance of hydroelectric output that will modify rates up or down depending on whether the utility has dry or wet winters. In exchange, SMUD saves the insurance premiums paid to a third party for hedging that risk. The action will help save money for customers over the long run and maintain SMUD's credit ratings by smoothing cost spikes. To ensure that SMUD continues to meet all obligations to its customers and bond holders, the Board is considering a 9.5 percent rate increase that would go into effect in September 2009.

The current economic climate forces SMUD to contain costs wherever possible without affecting the reliable delivery of electricity. At the same time, SMUD will not lose sight of the pressing need to implement the three major initiatives described in the following pages.

In early 2009, SMUD's residential rate was approximately 30 percent lower than neighboring PG&E's.

A Future Beyond Carbon





As a publicly owned utility, SMUD looks at environmental sustainability as a dividend it can provide back to the community.

Carbon is the world's fourth most abundant element. Life as we know it couldn't exist without it. Carbon's use in the generation of electricity helps cool our homes, dry our clothes, light our living rooms and wash our dishes.

But carbon dioxide is also the most abundant of the greenhouse gases, which means the emissions from power generation contribute greatly to air pollution, global warming and climate change. It also means SMUD can't keep doing business the way utilities have traditionally done business. The sustainability of our way of life is at stake.

In 2008, SMUD began implementing three long-term initiatives that will help make this a more livable, sustainable community.

Customers have always expected two basic things from SMUD: affordable rates and reliable service. SMUD has consistently provided both to the residents of Sacramento County for more than 60 years, and its customers have reciprocated by rating SMUD the top electric utility in the state in terms of customer satisfaction.

Keeping the lights on and maintaining affordable rates gives SMUD a lot of goodwill with its customers. But there is also an environmental benefit that SMUD can offer. As a publicly owned utility, SMUD looks at environmental sustainability — moving beyond carbon while maintaining affordability and reliability — as a dividend it can provide back to the community.

If SMUD continued to rely on fossil fuels for the generation of its electricity, SMUD would experience increased regulatory costs and the environmental consequences of poor local air quality. Customers would rightfully ask why SMUD didn't see this coming and take early action. SMUD has long enjoyed a reputation as one of the nation's

SMUD plans to reduce carbon dioxide emissions to 10 percent of 1990 levels by 2050.

"greenest" utilities. Its founders had the foresight to build the Upper American River Project in the late 1950s. SMUD built the largest utility-owned solar plant in 1994. SMUD was chosen by the U.S. Department of Energy to operate a fleet of hydrogen fuel cell vehicles. The foresight that SMUD exhibits today will result in the actions that create a sustainable future.

In 2008, SMUD began implementing three long-term initiatives that will help make this a more livable, sustainable community. The combined effect of these initiatives — Sustainable Power Supply, Compact with the Customer and Workforce Development — will be felt for decades to come.

Customers have always expected two basic things from SMUD: affordable rates and reliable service.

Sustainable Power Supply

Geothermal (above) and hydroelectricity (below) provide clean power and will help SMUD achieve its ambitious renewable energy goals.

In 2008, the SMUD Board adopted the most aggressive long-term carbon reduction goal of any utility in the state. SMUD aims to reduce its greenhouse gas emissions from the generation of electricity to 10 percent of its 1990 levels by 2050. This goal goes well beyond the standard set by Gov. Schwarzenegger in 2005, calling for California to reduce emissions to 20 percent of 1990 levels by 2050.

To achieve these aggressive goals, SMUD is pursuing a wide range of alternatives, including energy efficiency, renewable power supplies, carbon sequestration, energy storage and distributed technologies. Energy efficiency is the most cost effective way for SMUD and Sacramento to move beyond carbon. SMUD is committed to helping its customers reduce their energy use by 15 percent over the next 10 years. Every kilowatt-hour saved through energy efficiency means one less kilowatt-hour that needs to be generated by a power plant.

Every kilowatt-hour saved through energy efficiency means one less kilowatt-hour that needs to be generated by a power plant.

SMUD's energy efficiency programs have resulted in customer savings of more than $550 million over the last 35 years. Since energy-efficient improvements often require an initial investment, SMUD offers a wide

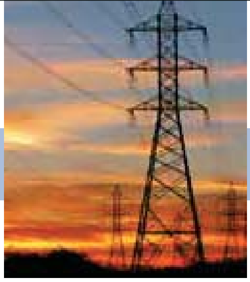
Hydropower is SMUD's most economical energy source.

range of incentives, rebates and financing on such household equipment as air conditioners, clothes washers, refrigerators and whole-house fans.

The SMUD Board also increased its goals for renewable energy. SMUD aims to have renewable energy account for 33 percent of its delivered power supply by 2020.

SMUD expects to be the first California electric utility to reach the 20-percent renewable target. At the end of 2008, renewables accounted for approximately 17 percent of SMUD's power supply. By 2010, 23 percent of SMUD's power supply should come from renewable sources when the additional 3 percent from SMUD's award-winning Greenergy® program is factored in.

Whether capturing the power of wind or converting methane into clean electricity through dairy digesters, SMUD is known nationally as one of the "greenest" utilities.



High-tech solutions such as programmable thermostats and simple solutions like shade trees will help reduce Sacramento's reliance on carbon-based fuels.

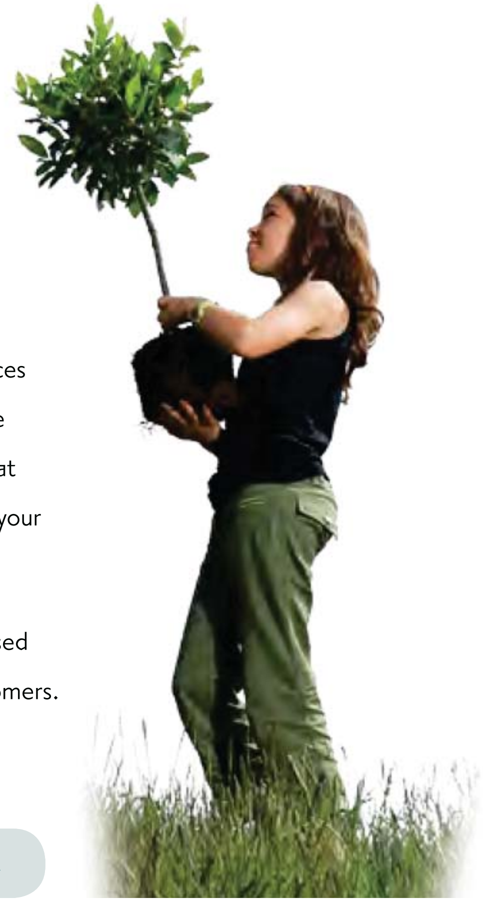
Most SMUD customers glance at their electric bill once a month and simply pay the amount due. **They don't think about their publicly owned utility much, and in one sense, that's good. It means SMUD is doing its job — providing reliable electricity at affordable rates.**

Without losing sight of the importance of meeting the region's daily needs, SMUD must look much farther ahead. If Sacramento is to reduce its reliance on carbon-based fuels and meet the ambitious goals set by SMUD and the California legislature, how do we get from here to there?

The Compact with the Customer will help bridge that gap. SMUD is investing in new technologies that will provide customers the information necessary to meet those community goals. Between 2009 and 2011, SMUD will install more than 600,000 advanced two-way meters that will help customers use energy more efficiently.

The new technologies will allow customers to make energy choices based on cost, comfort and convenience.

While the meters make good business sense for SMUD because they will reduce operating costs and improve reliability, this technology will also provide the foundation for a new relationship between SMUD and its customers.



The new technologies will allow customers to make energy choices based on cost, comfort and convenience. Imagine a future where your appliances, electronic devices and programmable thermostat communicate with your electric meter, or where you can call up your energy profile on a laptop or a cell phone from any location.

The value comes not from the actual meters but from the increased information and capability the new technology will provide customers.

SMUD's online energy analysis at www.smud.org helps customers reduce their monthly electric bills.

When integrated, these technologies form what many are calling the "smart grid." It has the potential to transform utilities to provide the sort of access and customer control now seen in other industries such as banking, travel and telecommunications.

A smart grid will tap into the entrepreneurial efforts of the burgeoning clean technology industry.

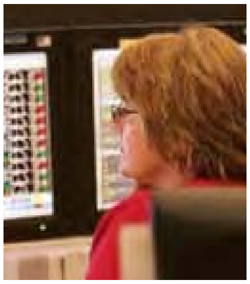
In 2008, SMUD developed a vision for the deployment of a smart grid that will tap into the entrepreneurial efforts of the burgeoning clean technology industry. New battery technologies could assist in making small-scale generation a viable alternative to large power stations.

SMUD is also expanding its communication efforts to help customers better understand what's coming and introduce them to the benefits of these exciting technologies.

If every U.S. home replaced just one light bulb with an ENERGY STAR® qualified compact fluorescent light bulb, the nation would save more than $600 million in annual energy costs.

The "Save Today, Save Tomorrow" marketing campaign that was launched in 2008 was one of the first steps in linking today's actions with tomorrow's results.

Developing a Dynamic Workforce



Now more than ever, SMUD must continue to attract a talented workforce to fulfill its mission of providing the Sacramento region with affordable, reliable power.

Developing a sustainable power supply and giving customers the tools to make smart energy decisions are worthy initiatives.

But their success will ultimately depend on the people who put them in place. SMUD needs to replace engineers, line workers and power generation experts who are nearing retirement age. SMUD also needs to recruit and hire new people who will lead the complex transition to a low-carbon future.

The Workforce initiative will find and develop people who can guide SMUD through the dramatic changes coming its way.

SMUD employees are a loyal lot — they tend to stick around a long time. That continuity has obvious benefits. The flip side is that SMUD's workforce is getting older. Nearly half of SMUD's 2,100 employees could retire within the next five years.

Four hundred employees worked for SMUD when the public utility opened on Dec. 31, 1946.

The Workforce initiative will find and develop people who can guide SMUD through the dramatic changes coming its way. SMUD increased its marketing and educational outreach efforts to local middle schools, high schools and colleges in 2008.

SMUD is determining which job groups will be hit hardest by retirements and how to attract talented workers to fulfill its commitment to environmental sustainability. SMUD is also working with organizations such as Valley Vision and Linking Education and Economic Development, as well as two-year and four-year colleges, to educate the local workforce and help make the Sacramento region a national leader for green jobs.

SMUD is working with organizations to help make the Sacramento region a national leader for green jobs.

Jonathan Roachell (below, seated), a newly hired power system operator for SMUD, receives daily supervision from veteran PSO Mike Flynn (right). Knowledge transfer is a key aspect of SMUD's Workforce initiative.

Home of the Future

Mitch Wright and Bonnie Darrah bought SMUD's Home of the Future in Folsom. The home is the only LEED Platinum certified home in the Sacramento region.

The Crafstman-style bungalow doesn't look particularly futuristic from the curb. Inside the "Home of the Future," it's a different story.

The home's monthly energy bill will cost the owner less than a dinner in one of Folsom's trendy restaurants. It's estimated that the owner should pay no more than $24 per month in combined electric and gas bills. Similar newly built homes in the region have monthly energy bills of about $140.

It's estimated that the owner should pay no more than $24 per month in combined electric and gas bills.

SMUD provided financial incentives and technical advice in a partnership to build the home with RJ Walter Homes, the National Renewable Energy Laboratory and the Building Science Corp. The home incorporates the latest in renewable and energy efficiency technologies, from photovoltaic panels to countertops made of recycled paper to drought-resistant landscaping.

The home is the only LEED (Leadership in Energy and Environmental Design) Platinum certified home in the Sacramento region, and just the third in the state. Despite the region's housing downturn, the home was sold just two months after being put on a challenging real estate market.

With 46,000 members, SMUD's Greenergy® program is the nation's fifth-largest green pricing program.

The home incorporates the latest in renewable and energy efficiency technologies.

Mitch Wright and Bonnie Darrah use the latest in technology to make sure their chocolate lab, Max, stays comfortable at all hours of the day.

Energy Help

SMUD customers and employees assist neighbors in need through the EnergyHELP program and local Habitat for Humanity projects.

In less than six years, SMUD's EnergyHELP program has exceeded $1 million in voluntary customer contributions. Nearly 11,000 SMUD customers give more than $32,000 a month to assist low-income customers who are having trouble paying their bills.

Since the program started in early 2004, more than 6,500 households have been assisted by EnergyHELP money. In 2008, 2,400 households received EnergyHELP assistance.

EnergyHELP customers contribute automatically in their monthly bill payment to any of four charities.

EnergyHELP customers contribute automatically in their monthly bill payment to any of four charities: the Salvation Army, the Sacramento Food Bank & Family Services, Travelers Aid Emergency Assistance Agency, and the Folsom Cordova Community Partnership. The donation is tax deductible, and SMUD sends 100 percent straight to the charity.

Combined Charities

SMUD customers weren't the only good Samaritans in tough economic times. In 2008, SMUD employees donated a record amount of money to the District's annual Combined Charities campaign. More than one-third of SMUD employees pledged or made donations totaling $348,235, exceeding the previous high established in the flusher economic times of 2005.

In 2008, SMUD employees donated a record amount of money to the District's annual Combined Charities campaign.

The Combined Charities Campaign is a voluntary effort to support local, regional and national non-profit organizations. Employees can donate through payroll deductions or make a one-time donation.

Customers who qualify for SMUD's energy assistance program are eligible to have their homes weatherized for free.

Rancho Seco Decommissioning

When it came to the radiological decommissioning of the Rancho Seco Nuclear Plant, SMUD made the best of a difficult assignment.

Decommissioning began in 1997, eight years after the residents of Sacramento County voted to shut down the 913-megawatt nuclear plant. It was totally uncharted territory for SMUD. Never before had a nuclear facility the size of Rancho Seco been disassembled and decontaminated.

SMUD staff removed more than 30 thousand tons of radioactive steel, concrete and debris. In 2002, used nuclear fuel was placed in dry storage, a massive, $68 million project in and of itself. The reactor vessel had to be disassembled. In early 2008, a 250-ton crane in the reactor building was demolished with explosives.

While decommissioning of the Rancho Seco nuclear plant was concluded in 2008, Rancho Seco Lake has long been a popular site for recreational activities such as sailing and fishing.

More than 110,000 people used SMUD's Rancho Seco Recreational Area in 2008.

When the physical decommissioning was finished in the final days of 2008, remaining radioactivity from the plant measured just 0.5 percent of naturally occurring levels, or one-tenth the limit established by the Nuclear Regulatory Commission. The $500 million project came in $30 million under budget.

Approximately half of the nearly 2,500-acre property is committed to conservation easements and recreational facilities. One of the nation's first utility-scale photovoltaic facilities occupies several acres. The natural gas-fired Cosumnes Power Plant operates directly south of the shuttered nuclear plant.

A groundbreaking solar program received an enthusiastic thumbs-up from SMUD customers in 2008.

With the electricity provided by 17,172 solar panels on a turkey farm in Wilton, Solar Shares customers own a piece of the sun. For a fixed monthly price based on their usage, participants receive a credit on each bill for their share of the solar power produced at the 1-megawatt solar farm in southeastern Sacramento County. Solar Shares subscriptions sold out in early 2009.

Solar Shares is the first and largest "virtual solar" program of its kind in the nation.

Solar Shares is the first and largest "virtual solar" program of its kind in the nation. It was implemented in July to give all SMUD customers — not just those who could afford their own solar system or own their homes — an opportunity to get clean, locally produced power. For between $4 and $50 per month, SolarShares subscribers ensure that between 20 to 40 percent of their power comes from SMUD's new solar farm. As SolarShares customers lock in a price for solar power, the program costs will decrease as electricity costs rise.

By signing a 20-year power purchase agreement with enXco to build, own and operate the solar farm in Wilton, the renewable energy developer claims investment tax credits that aren't available to a non-profit organization such as SMUD.

BELOW *SMUD employees, below, team with enXco workers to help install solar panels on a turkey farm in Wilton.* RIGHT *Anya, Evan and Jeff Suneson receive renewable power from the Wilton facility through SMUD's innovative SolarShares program.*

SMUD plans to have 33 percent of its power come from renewable resources by 2020.

Clean Transportation

As electric transportation gains traction, the groundwork laid by SMUD will help the Sacramento region adapt to this cleaner technology.

SMUD is working to improve local air quality through the use and promotion of electric transportation. SMUD's electric vehicle charging rate is approximately half the regular residential rate. SMUD is also looking at the infrastructure options to sustain a viable electric transportation system in the region.

SMUD is working to improve local air quality through the use and promotion of electric transportation.

In conjunction with BP, Ford and the U.S. Department of Energy, SMUD opened a hydrogen fuel cell electric vehicle charging station in 2008 on its Sacramento campus. The station produces hydrogen from an on-site array of solar panels.

SMUD also purchased hybrid bucket trucks that allow the engine to be shut down while crews do repair and maintenance work.

In addition to using all-electric and hybrid vehicles in its fleet, SMUD operates about 70 flex-fuel vehicles. SMUD also "greened" its maintenance operations by using re-refined motor oil in its vehicles.

SMUD is "greening" its maintenance fleet with such additions as an electric-diesel hybrid bucket truck.

SMUD's charging rate for electric vehicles is approximately half the regular residential rate.

SMUD's hydrogen refueling station is powered by Sacramento's plentiful sunshine.

2008 FINANCIAL STATEMENTS

5 YEAR SUMMARY (UNAUDITED)

Operating Statistics (i)	2008	2007	2006	2005	2004
Customers at year-end	592,490	589,599	585,221	577,946	567,176
KWH Sales (thousands)					
Sales to customers –					
Residential	4,696,912	4,608,170	4,760,391	4,534,276	4,446,117
Commercial, industrial & other	6,219,838	6,209,689	6,038,839	5,951,447	5,790,984
Subtotal	10,916,750	10,817,859	10,799,230	10,485,723	10,237,101
Sales of surplus power	2,460,487	2,427,964	3,964,326	1,496,569	858,234
Total	13,377,237	13,245,823	14,763,556	11,982,292	11,095,335
Revenues (thousands of dollars)					
Sales to Customers –					
Residential	$ 540,546	$ 493,910	$ 515,025	$ 480,100	$ 442,704
Commercial, industrial & other	627,571	589,922	566,851	557,305	527,828
Subtotal	1,168,117	1,083,832	1,081,876	1,037,405	970,532
Sales of surplus power	170,640	134,002	191,931	73,475	23,856
Sales of surplus gas	139,275	78,292	112,719	114,313	62,022
Total (ii)	$ 1,478,032	$ 1,296,126	$ 1,386,526	$ 1,225,193	$ 1,056,410
Average kWh sales per residential customer	8,982	8,841	9,202	8,909	8,927
Average revenue per residential kWh sold (cents)	11.11	10.49	10.60	10.41	9.91
Power supply (thousands of kWh)					
Hydroelectric	886,728	1,056,893	2,804,704	2,236,818	1,259,570
Cogeneration	5,995,248	5,886,579	4,775,933	2,196,055	2,417,533
Windpower	261,338	117,197	73,887	36,828	41,644
Photovoltaic	2,655	2,235	2,323	2,341	2,201
Gas turbine	–	181	7,918	2,225	13,445
Purchases	6,756,059	6,724,160	7,679,518	7,968,762	7,853,322
Net system peak demand – 1 hour (kW)	3,086,000	3,099,000	3,280,000	2,959,000	2,672,000
Equivalent Full Time Employees at year-end	2,197	2,226	2,213	2,279	2,209
Financial Statistics (thousands of dollars)					
Operating revenues	$ 1,486,679	$ 1,312,083	$ 1,354,427	$ 1,225,193	$ 1,068,727
Operating expenses –					
Purchased and interchanged power	446,302	385,021	388,714	463,710	373,362
Operation and maintenance	752,554	666,661	620,002	461,229	398,696
Depreciation and amortization	145,196	133,603	125,937	107,751	99,754
Decommissioning	4,700	31,620	30,894	29,408	29,166
Total operating expenses	1,348,752	1,216,905	1,165,547	1,062,098	900,978
Operating income	137,927	95,178	188,880	163,095	167,749
Other income	38,365	47,340	47,421	26,591	24,972
Income before interest charges	176,292	142,518	236,301	189,686	192,721
Interest charges	164,322	147,101	128,895	106,414	108,860
Net increase (decrease) in net assets before extraordinary income	$ 11,970	$ (4,583)	$ 107,406	$ 83,272	$ 83,861
Extraordinary Income	$ 10,168	$ –	$ –	$ –	$ –
Net increase (decrease) in net assets	$ 22,138	$ (4,583)	$ 107,406	$ 83,272	$ 83,861
Funds available for revenue bond debt service	$ 264,100	$ 245,604	$ 345,293	$ 310,257	$ 310,739
Revenue bond debt service	$ 174,846	$ 181,706	$ 174,121	$ 160,036	$ 136,929
Revenue bond debt service coverage ratio	1.51	1.35	1.98	1.94	2.27
Electric utility plant – net	$ 2,926,746	$ 2,882,321	$ 2,734,776	$ 2,662,311	$ 2,493,785
Capitalization					
Long-term debt	$ 3,205,101	$ 3,173,216	$ 2,518,309	$ 2,303,188	$ 2,406,325
Customer's equity	$ 510,549	$ 488,411	$ 492,994	$ 385,588	$ 302,316

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

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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, 2008 and 2007, 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, 2008 and 2007, 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 3, the Sacramento Municipal Utility District adopted the provisions of FASB Statement No. 157 – Fair Value Measurements, effective January 1, 2008, prospectively, for interest rate swap agreements and natural gas and electricity derivative financial instruments that are measured at fair value on a recurring basis.

The management's discussion and analysis on pages 2 through 15 and the Schedules of Funding Progress are not a required part of the consolidated financial statements, but is supplementary information required by the Governmental Accounting Standards Board. 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 20, 2009

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, 2008 and 2007. 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 (Board) 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 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. In May 2008, the Board approved a Hydro Generation Adjustment (HGA) mechanism effective July 1, 2008. The HGA will automatically adjust rates in April each year based on the precipitation results from the previous April 1 through March 31. The increase or decrease in rates will be limited to a maximum rate change of four percent. The HGA also established a Hydro Rate Stabilization Fund (HRSF) with the transfer of $30 million from the Rate Stabilization Fund. In 2008, $15 million from the HRSF was recognized as revenue to cover the budget impact of low precipitation.

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, 2008, the District had total regulatory costs for future recovery of $366 million, which is a net increase of $190 million from 2007. The increase is primarily due to a change in the valuation of derivative financial instruments. At December 31, 2007, the valuation of derivative financial instruments resulted in a deferred credit of $79 million. Due to significant price changes in the power and gas markets, the valuation of derivative financial instruments at December 31, 2008 has swung to a deferred cost of $182 million. There was also an increase in the deferred cost of decommissioning reflecting a higher estimate for the total cost of decommissioning the Rancho Seco nuclear plant site. The District also had regulatory credits of $319 million as of December 31, 2008, which is a net decrease of $73 million from 2007. The decrease is primarily due to the change in the valuation of derivative financial instruments, as discussed above, and changes in the Rate Stabilization Fund. During 2008, $30 million from the Rate Stabilization Fund was used to establish the HRSF, of which $15 million was recognized as revenue. Additionally, deferred revenue related to precipitation hedges decreased by $11 million as a result of a change in the District's hedging strategy and the establishment of the HGA as discussed earlier. 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	2008	December 31, 2007	2006
		(millions of dollars)	
Assets			
Electric Utility Plant – net	$ 2,927	$ 2,882	$ 2,735
Restricted and Designated Assets	274	273	286
Current Assets	739	734	781
Noncurrent Assets and Deferred Charges	1,159	1,077	331
	$ 5,099	$ 4,966	$ 4,133
Liabilities and Net Assets			
Long-Term Debt – net	$ 3,205	$ 3,173	$ 2,518
Current Liabilities and Deferred Credits	740	724	542
Noncurrent Liabilities and Deferred Credits	643	580	580
Net Assets:			
Invested in capital, net of related debt	274	321	252
Restricted	123	95	89
Unrestricted	114	73	152
	$ 5,099	$ 4,966	$ 4,133

ASSETS

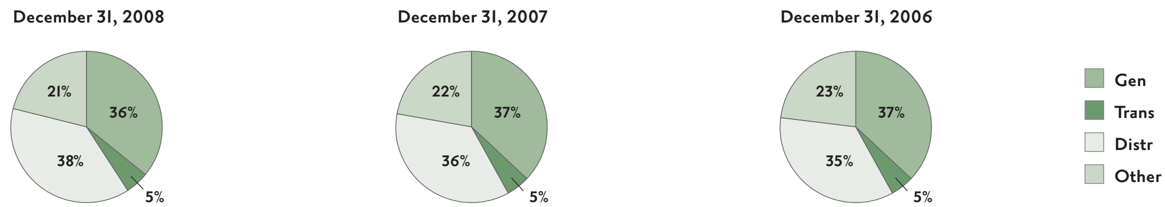
Utility Plant – net

2008 Compared to 2007 The District has invested approximately $2.9 billion in utility plant assets and construction work in progress net of accumulated depreciation at December 31, 2008. Net utility plant makes up about 57 percent of the District's assets, approximately 1 percent less than the previous year. During 2008, the District capitalized approximately $200 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.

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.

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 18 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:



Restricted and Designated Assets

2008 Compared to 2007 The District's level of Restricted and Designated Assets increased by $1 million during 2008. There was a significant decrease in the Nuclear Decommissioning Trust Fund reflecting continued progress on decommissioning the Rancho Seco nuclear plant site, a decrease in the Rate Stabilization Fund as a result of recognizing $15 million in current year revenues to offset the budget impacts of low precipitation, and a $44 million reduction in Securities Lending Collateral held by the District. These decreases were more than offset by increase of Revenue Bond, Debt Service and Construction Reserve funds and a significant reduction in the current portion of 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.

Current Assets

2008 Compared to 2007 Current Assets increased by $5 million in 2008 due to increases in Unrestricted Cash and Cash Equivalents, Receivables for both retail and wholesale customers, Regulatory Costs to be recovered within one year, Materials and Supplies, and Prepayments. These increases were partially offset by a lower current portion of Restricted and Designated Assets, a lower current portion of Conservation Loans, and a lower current portion of Derivative Financial Instruments.

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.

Noncurrent Assets and Deferred Charges

2008 Compared to 2007 Total Noncurrent Assets and Deferred Charges increased by $83 million due to higher Regulatory Costs for future recovery. This increase is mainly due to deferred costs for the change in value of Derivative Financial Instruments resulting from significant price changes in the power and gas markets. Additionally, there were increases in the long-term portion of Conservation Loans and Preliminary Projects and Other. These increases were partially offset by a reduction in the value of Derivative Financial Instruments.

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.

LIABILITIES

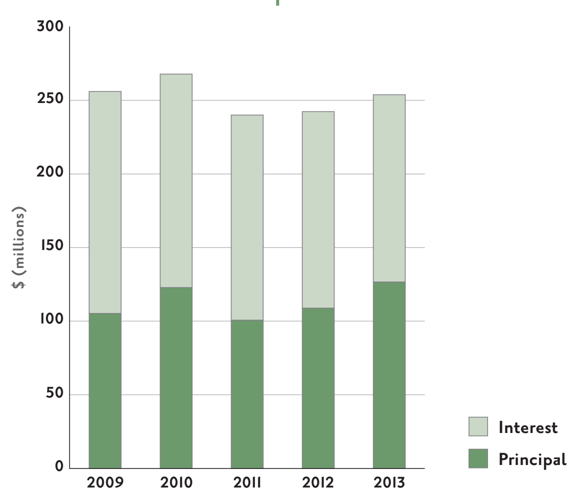
Long-Term Debt

2008 Compared to 2007 In June 2008, the District issued $522 million of fixed-rate Series U Electric Revenue Refunding Bonds to refund outstanding fixed-rate bonds and various Auction Rate Securities, and to reimburse for construction expenditures. In August 2008, the District issued $198 million of variable-rate Series J and Series K Subordinated Electric Revenue Refunding Bonds to refund various Auction Rate Securities. For more details refer to Note 10.

2007 Compared to 2006 In May 2007, 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.

The following graph shows the District's future debt service requirements through 2013 as of December 31, 2008:

Debt Service Requirements



As of December 31, 2008, 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 rated by the rating agencies at the higher of the insurer's rating or the District's underlying rating.

Current Liabilities and Deferred Credits

2008 Compared to 2007 Current Liabilities and Deferred Credits increased by approximately $16 million during 2008. During 2008, the District issued $50 million of Commercial Paper Notes to finance or reimburse capital expenditures. The current portion of the value of Derivative Financial Instruments increased by $73 million as a result of significant price changes in the power and gas markets. These increases were partially offset by decreases in Accounts Payable, the current portion of Accrued Decommissioning reflecting the near completion of radiological decommissioning of the Rancho Seco nuclear plant site, and a lower amount held as Securities Lending Collateral.

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.

Noncurrent Liabilities and Deferred Credits

2008 Compared to 2007 Noncurrent Liabilities and Deferred Credits increased by nearly $63 million during 2008. Accrued Decommissioning increased by $15 million reflecting a higher estimate for the total cost of decommissioning the Rancho Seco nuclear plant site. Also, the value of the liability for Derivative Financial Instruments increased by approximately $141 million due to significant price changes in the power and gas markets. These increases were partially offset by a reduction in Regulatory Credits due to recognition of revenue from the Rate Stabilization Fund to offset the budget impacts of low precipitation, a reduction of deferred revenues related to precipitation hedges, a reduction in the deferred credit for the change in value of Derivative Financial Instruments. Additionally, the Credit Support Collateral Obligation decreased by $23 million.

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.

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

	December 31, 2008	2007	2006
		(millions of dollars)	
Operating revenues	$ 1,487	$ 1,312	$ 1,354
Operating expenses	(1,349)	(1,217)	(1,165)
Operating income	138	95	189
Other revenues	38	47	47
Interest charges	(164)	(147)	(129)
Net increase/(decrease) in net assets before extraordinary income	12	(5)	107
Extraordinary income	10	-0-	-0-
Increase/(decrease) in net assets	22	(5)	107
Net assets – beginning of year	488	493	386
Net assets – end of year	$ 510	$ 488	$ 493

CHANGES IN NET ASSETS

Operating Revenues

2008 Compared to 2007 Operating Revenues were $1.5 billion in 2008, an increase of $175 million over 2007. Sales to retail customers were $1.2 billion in 2008, an increase of $80 million as compared to 2007 sales. The District sold about 1 percent more energy to its retail customers, which grew from 589,599 customers in 2007 to 592,490 customers in 2008, at an average revenue per kilowatt hour that increased by 6.5 percent. The District transferred $16 million from the Rate Stabilization Fund as compared to a transfer from the Rate Stabilization Fund of $16 million in 2007. The District also deferred approximately $8 million of Senate Bill 1 revenues to match them against the expenditures in future periods.

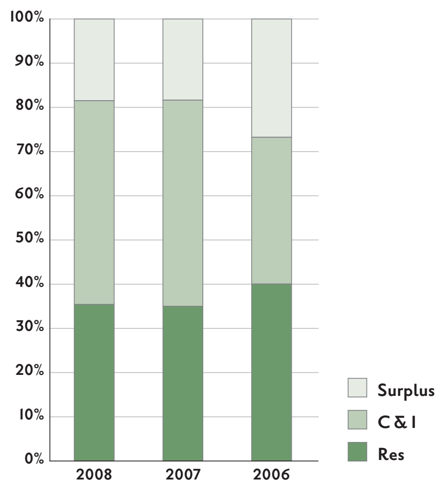
Wholesale revenues are comprised of both surplus energy and gas sales. In 2008, surplus gas sales were $139 million as compared to $78 million in 2007. The amount of surplus gas sold was higher, but at slightly lower average prices. Surplus energy sales in 2008 were $37 million higher than in 2007. The increase is due to higher volume (1 percent) at higher average prices (26 percent) than in 2007.

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.

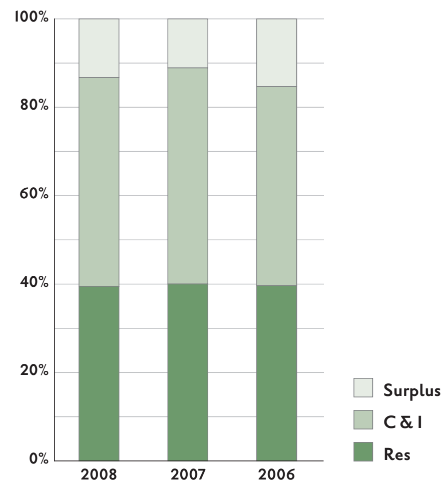
Wholesale revenues are comprised of both surplus energy and gas sales. In 2007, surplus gas sales were $78 million as compared to $113 million in 2006. The amount of surplus gas sold was lower, although at slightly higher average prices. Surplus energy sales in 2007 were $58 million lower than in 2006. 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.

The following graphs show the percentage of megawatt hour (MWh) sales and sales revenue in 2008, 2007, and 2006 by surplus energy sales (Surplus), commercial and industrial (C&I), and residential (Res) customers:

MWh Sales



Sales Revenues



Operating Expenses

2008 Compared to 2007 Operating Expenses were $1.3 billion in 2008, approximately $132 million higher than in 2007. Purchased Power expense was $61 million higher in 2008 mainly due to higher average prices and slightly more energy purchased as compared to 2007. Only one-half percent more energy was purchased in 2008 at average prices that were 15 percent higher than in 2007. The District reduced Purchased Power expense by $20 million through the use of precipitation hedges and insurance. In 2008, fuel costs for generation, a component of Production Costs, were approximately $237 million, or $3 million higher than 2007. More fuel was used in 2008 (927 thousand decatherms), primarily due to higher production at the Sacramento Municipal Utility District Financing Authority (SFA) (3 percent). Average fuel prices were 2 percent lower in 2008 as compared to 2007.

Public Good expenses increased by $7 million during 2008 as a result of more energy efficiency expenditures and customer incentive payments.

Maintenance expense was $7 million higher in 2008 due to higher Solano Wind Project maintenance, increased transmission and distribution preventative maintenance, and for maintenance related to storm damage early in 2008.

Depreciation expense increased by nearly $12 million due to a change in the remaining service life for meters as the District transitions to advanced metering technology and due to additional capitalization of plant at the Solano Wind Project.

Decommissioning expense was lower by $27 million in 2008 due to the District stopping contributions to the Nuclear Decommissioning Trust Fund. It was determined early in 2008 that there were enough funds in the trust to complete the radiological decommissioning of the Rancho Seco nuclear plant site.

In 2008, power supply costs made up approximately 66 percent of total Operating Expenses as compared to 62 percent for 2007.

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 SFA and higher generation production for Central Valley Financing Authority and Sacramento Power Authority. 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 the Transmission Agency of Northern California (TANC) transmission as a result of TANC implementing an Open Access Transmission Tariff for its members and California Independent System Operator transmission charges.

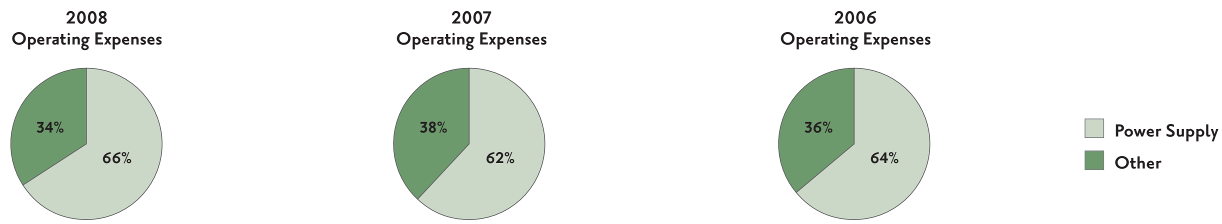
The District's expenses for Administrative, General, and Customer were $10 million higher in 2007 due to the expense for the District's Other Post-Employment Benefits unfunded accrued liability, improvements to customer service, and a higher provision for uncollectible conservation loans to customers. 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.

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 2008, 2007, and 2006:



Other Revenues

2008 Compared to 2007 Other Revenues were $9 million lower in 2008 as compared to 2007. Interest Income was $11 million lower due to lower interest rates and lower securities lending income, partially offset by a swap termination payment of approximately $4 million. The lower revenues were partially offset by higher Other Income of about $2 million.

2007 Compared to 2006 Other Revenues were 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.

Interest Charges

2008 Compared to 2007 Interest Charges in 2008 were $17 million higher than in 2007, due mainly to higher interest on long-term debt from NCGA debt being outstanding for the entire year. Additionally, the amount of commercial paper notes outstanding during the year was higher than in 2007 resulting in more interest expense.

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.

Extraordinary Income

The District also recorded Extraordinary Income in 2008 of $10 million due to a natural gas anti-trust litigation settlement and a bankruptcy settlement related to purchased power.

CONSOLIDATED BALANCE SHEETS

Assets	December 31, 2008	2007
	(thousands of dollars)	
Electric Utility Plant		
Plant in service	$ 4,186,435	$ 4,002,026
Less accumulated depreciation and depletion	(1,496,838)	(1,369,030)
Plant in service – net	2,689,597	2,632,996
Construction work in progress	237,149	249,325
Total electric utility plant – net	2,926,746	2,882,321
Restricted and Designated Assets		
Revenue bond, debt service and construction reserves	260,893	243,347
Nuclear decommissioning trust fund	38,333	69,865
Rate stabilization fund	74,775	91,143
Securities lending collateral	31,400	75,284
Other funds	805	803
Less current portion	(132,087)	(207,741)
Total restricted and designated assets	274,119	272,701
Current Assets		
Unrestricted cash and cash equivalents	192,289	169,922
Restricted and designated cash and cash equivalents	78,422	129,803
Restricted and designated investments	53,665	77,938
Receivables – net:		
Retail customers	145,147	137,622
Wholesale	42,397	40,021
Conservation loans due within one year, accrued interest and other	21,556	39,076
Regulatory costs to be recovered within one year	98,363	39,464
Derivative financial instruments maturing within one year	10,222	22,870
Materials and supplies	54,294	44,110
Prepaid Gas	22,102	22,220
Prepayments	20,099	10,952
Total current assets	738,556	733,998
Noncurrent Assets and Deferred Charges		
Regulatory costs for future recovery	267,608	136,762
Prepaid Gas	699,705	721,806
Advance capacity payments	26,631	31,548
Derivative financial instruments	52,620	88,054
Unamortized debt issuance costs	36,264	35,671
Conservation loans	58,684	52,615
Preliminary project studies and other	17,735	10,265
Total noncurrent assets and deferred charges	1,159,247	1,076,721
Total Assets	$ 5,098,668	$ 4,965,741

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

CONSOLIDATED BALANCE SHEETS

Liabilities	December 31, 2008	2007
	(thousands of dollars)	
Long-Term Debt – net	$ 3,205,101	$ 3,173,216
Current Liabilities and Deferred Credits		
Commercial paper notes	200,000	150,000
Accounts payable	85,718	112,652
Purchased power payable	69,491	73,022
Credit support collateral obligation	11,050	9,650
Long-term debt due within one year	103,845	106,365
Accrued decommissioning	6,913	42,292
Accrued interest	52,995	52,118
Accrued salaries and compensated absences	32,212	29,111
Derivative financial instruments maturing within one year	82,934	10,344
Regulatory credits to be recognized within one year	31,018	31,037
Securities lending collateral obligation	31,400	75,284
Customer deposits and other	32,729	32,198
Total current liabilities and deferred credits	740,305	724,073
Noncurrent Liabilities and Deferred Credits		
Accrued decommissioning	170,572	155,135
Derivative financial instruments	158,754	18,202
Regulatory credits	288,445	360,986
Credit support collateral obligation	-0-	22,500
Due to affiliated entity	10,572	6,571
Due to U.S. Bureau of Reclamation	5,508	6,200
Self insurance, deferred credits and other	8,862	10,447
Total noncurrent liabilities and deferred credits	642,713	580,041
Total Liabilities	4,588,119	4,477,330
Net Assets		
Invested in capital assets, net of related debt	273,555	320,700
Restricted	123,398	94,516
Unrestricted	113,596	73,195
Total Net Assets	510,549	488,411
Commitments and Contingencies (Notes 17 and 18)		
Total Liabilities and Net Assets	$ 5,098,668	$ 4,965,741

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

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Year Ended December 31, 2008	2007
	(thousands of dollars)	
Operating Revenues		
Residential	$ 540,546	$ 493,910
Commercial and industrial	621,199	580,489
Street lighting and other	6,372	9,433
Wholesale	309,916	212,294
Senate Bill - 1 revenue deferral	(7,722)	-0-
Rate stabilization fund transfers	16,368	15,957
Total operating revenues	1,486,679	1,312,083
Operating Expenses		
Operations:		
Purchased power	446,302	385,021
Production	430,563	364,467
Transmission and distribution	50,005	50,880
Administrative, general and customer	136,457	135,639
Public good	44,802	37,419
Maintenance	76,284	68,805
Depreciation	143,980	132,387
Depletion	14,443	9,451
Decommissioning	4,700	31,620
Regulatory deferrals collected in rates	1,216	1,216
Total operating expenses	1,348,752	1,216,905
Operating Income	137,927	95,178
Non-Operating Revenues and Expenses		
Other revenues		
Interest income	29,841	41,064
Other income – net	8,524	6,276
Total other revenues	38,365	47,340
Interest charges		
Interest on debt	167,588	151,650
Allowance for funds used during construction	(3,266)	(4,549)
Total interest charges	164,322	147,101
Increase (decrease) in Net Assets before Extraordinary Income	11,970	(4,583)
Extraordinary Income		
Natural gas and power settlement proceeds	10,168	-0-
Increase (decrease) in Net Assets	22,138	(4,583)
Net Assets – Beginning of Year	488,411	492,994
Net Assets – End of Year	$ 510,549	$ 488,411

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2008	2007
	(thousands of dollars)	
Cash Flows From Operating Activities		
Receipts from retail customers	$ 1,155,303	$ 1,081,945
Receipts from surplus power sales	170,335	137,002
Receipts from surplus gas sales	137,470	78,384
Receipts from federal and state grants	1,026	598
Receipts from steam sales	12,398	9,429
Natural gas and power settlement proceeds	26,636	-0-
Other receipts/payments	(3,852)	180
Repayment/receipts for credit support collateral, net	(28,650)	4,400
Issuance/repayment of conservation loans, net	(9,007)	(9,733)
Payments to employees – payroll and other	(219,213)	(218,084)
Payments for wholesale power	(471,132)	(378,507)
Payments for gas purchases	(353,789)	(304,372)
Payments to vendors/others	(157,683)	(121,064)
Payments/receipts for weather hedge/insurance	22,097	1,181
Payments for decommissioning	(30,389)	(56,189)
Net cash provided by operating activities	251,550	225,170
Cash Flows from Noncapital Financing Activities		
Net proceeds from bond issues	-0-	754,198
Repayment of debt	(18,665)	-0-
Prepaid gas supply expenditures	-0-	(754,107)
Interest on debt	(33,035)	(9,487)
Net cash used in noncapital financing activities	(51,700)	(9,396)
Cash Flows from Capital Financing Activities		
Construction expenditures	(224,300)	(267,443)
Contributions in aid of construction	18,972	24,421
Net proceeds from bond issues	738,910	-0-
Repayment and defeasance of debt	(694,938)	(98,080)
Issuance of commercial paper	50,000	150,000
Interest on debt	(128,499)	(128,115)
Net cash used in capital financing activities	(239,855)	(319,217)
Cash Flows from Investing Activities		
Sales and maturities of securities	300,861	363,471
Purchases of securities	(215,875)	(274,077)
Interest and dividends received	31,821	40,617
Securities lending collateral – net	(43,884)	(802)
Net cash provided by investing activities	72,923	129,209
Net increase in cash and cash equivalents	32,918	25,766
Cash and cash equivalents at the beginning of the year	379,790	354,024
Cash and cash equivalents at the end of the year	$ 412,708	$ 379,790
Cash and cash equivalents included in:		
Unrestricted cash and cash equivalents	$ 192,289	$ 169,922
Restricted and designated cash and cash equivalents	78,422	129,803
Revenue bond, debt service and construction reserves (a component of the total of $260,893 and $243,347 at December 31, 2008 and 2007, respectively)	141,997	80,065
Cash and cash equivalents at the end of the year	$ 412,708	$ 379,790

The accompanying notes are an integral part of these 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, 2008	2007
	(thousands of dollars)	
Operating income	$ 137,927	$ 95,178
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	143,980	132,387
Depletion	14,443	9,451
Regulatory deferrals collected in rates, including decommissioning	5,916	32,836
Amortization of advance capacity & other	4,990	4,991
Amortization of prepaid gas supply	22,220	10,081
Revenue (recognized from) deferred to regulatory credits, net	(9,816)	(17,207)
Natural gas and power settlement proceeds	26,636	-0-
Federal and State grants revenue	1,026	598
Repayment/receipts for credit support collateral, net	(28,650)	4,400
Other receipts/payments	439	(2,649)
Changes in operating assets and liabilities:		
Customer and wholesale receivables	(9,636)	8,662
Conservation loans	(9,007)	(9,733)
Other assets	(12,299)	(1,578)
Payables and accruals	(6,230)	13,942
Decommissioning	(30,389)	(56,189)
Net cash provided by operating activities	$ 251,550	$ 225,170

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

	Year Ended December 31, 2008	2007
	(thousands of dollars)	
Loss on defeasance of debt	(287)	-0-
Amortization of debt related costs	(3,496)	(5,069)
Unrealized holding gain	197	659
Change in valuation of derivative financial instruments	(261,224)	46,527
Amortization of revenue for assets contributed in aid of construction	8,135	7,637
Allowance for funds used during construction	3,266	4,549
Construction costs included in accounts payable	29,284	47,903

The accompanying notes are an integral part of these 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. 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 the acquisition, generation, 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 2008 and 2007 were 3.69 and 3.54 percent, respectively. Depreciation is calculated using the following estimated lives:

Generation	5 to 90 years
Transmission and Distribution	5 to 50 years
General	2 to 50 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 23 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 (Indenture) 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 made 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 determined early in 2008 that there were enough funds in the trust to complete the radiological decommissioning of the Rancho Seco nuclear plant site, and stopped contributing to the Trust Fund (see Note 13).

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 Operating Expense over the Utility Plant's life. Expenditures for decommissioning activities are recorded as reductions to Accrued Decommissioning liability. Changes in the 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, 2008 and 2007, the District's Accrued Decommissioning balance in the Consolidated Balance Sheets relating to Rancho Seco was $171.4 million and $191.7 million, respectively (see Note 13). The Accrued Decommissioning balance in the Consolidated Balance Sheets relating to other electricity generation and gas production facilities totaled $6.1 million and $5.7 million as of December 31, 2008 and 2007, 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 once per month 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, 2008 and 2007, unbilled revenues were $63.1 million and $61.2 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 counter-party 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, 2008 and 2007, the District held $11.1 million and $32.2 million, respectively, on deposit by counterparties. The amount is recorded as unrestricted cash with an associated short-term and long-term liability. At December 31, 2008, the District had $7.6 million in collateral on deposit with counterparties. On January 23, 2007, the District entered into a $50 million letter of credit facility to support collateral requirements under the District's various energy and natural gas purchase, sale and swap agreements.

Accounts Receivable and Allowance for Doubtful Accounts. Accounts Receivable is recorded at the invoiced amount and does 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 2008 and 2007 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, 2008	$ 24,242	$ 388	$ 48	$ 24,582
December 31, 2007	$ 24,577	$ 424	$ 759	$ 24,242
Wholesale Power and Other:				
December 31, 2008	$ 1,249	$ 640	$ 208	$ 1,681
December 31, 2007	$ 1,305	$ 333	$ 389	$ 1,249
Retail Customers:				
December 31, 2008	$ 4,179	$ 4,600	$ 5,897	$ 2,882
December 31, 2007	$ 2,989	$ 6,707	$ 5,517	$ 4,179
Conservation Loans:				
December 31, 2008	$ 1,729	$ 2,052	$ 1,432	$ 2,349
December 31, 2007	$ 1,370	$ 1,405	$ 1,046	$ 1,729

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, 2008 and 2007, the total estimated liability for vacation and other compensated absences was $23.5 million and $22.6 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 (AFUDC). The District capitalizes, as an additional cost of Construction Work In Progress (CWIP), 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 2008 and 2007 were 3.2 percent and 4.2 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 in 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 (CIAC). The District records CIAC from customer contributions, primarily relating to expansions to the District's distribution facilities, as Non-operating 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 2008 and 2007, the District recognized grant proceeds of $1.1 million and $0.5 million, respectively, as a component of Interest and Other Income, in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets.

Extraordinary Income. During 2008, the District received several settlements that were considered extraordinary income. The District was involved in a natural gas antitrust litigation settlement, and received $9.4 million in June 2008, and an additional $16.5 million in December 2008. The $9.4 million was recorded as an extraordinary item in 2008, and passed through to the component units. The Board opted to defer $16.5 million to be recognized as revenue in 2009 for rate-making purposes. One third of the deferred amount was recognized in January 2009, with the remainder to be recognized equally in February and March 2009. The District also received $0.7 million in 2008 related to a bankruptcy claim related to sales into the California market that were related to gaming activities. This amount was for purchased power, and was not passed through to the component units.

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.

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.

The District has identified a termination benefit liability related to certain employees at the Rancho Seco site, which will complete non-radiological decommissioning in 2012. 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 Other Post Employment Benefits (OPEB) after termination. As of December 31, 2008, ten employees had retention agreements totaling $0.5 million, recorded as a component of Customer Deposits and Other on the Consolidated Balance Sheets.

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"* (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 was effective for the District beginning in 2007 (see Note 15).

In September 2006, GASB issued SGAS No. 48, *"Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues"* (GASB No. 48), which requires the disclosure of pledged future revenues. GASB No. 48 was effective for the District beginning in 2007. The disclosures required by this statement are included in Note 10.

In September 2006, FASB issued SFAS No. 157, "Fair Value Measurements" (FASB No. 157). FASB No. 157 provides guidance for using fair value to measure assets and liabilities. The statement clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability. The statement 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 (see Note 3)

The effective date for AROs that are measured at fair value on a nonrecurring basis will be January 1, 2009. FASB Staff Position (FSP) FAS 157-2 *"Effective Date of FASB Statement No. 157,"* issued February 12, 2008, provides a one year delay in the effective date for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value on a nonrecurring basis. The District is currently assessing the financial statement impact of adopting this portion of the statement, but does not believe that its impact will be material.

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 was effective for the District beginning in 2008. The District has had no known pollution remediation obligations and thus, no liability has been recorded in the financial statements.

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 non-financial in nature, and have an initial useful life extending beyond a single reporting period. The statement 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.

Emerging Issues Task Force (EITF) Issue No. 06-03. Effective January 1, 2007, the District adopted the 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."*

Reclassifications. Certain amounts in the 2007 consolidated financial statements have been reclassified in order to conform to the 2008 presentation.

NOTE 3. ACCOUNTING CHANGE

FASB No. 157. Effective January 1, 2008, the District adopted FASB No. 157, prospectively, for interest rate swap agreements and natural gas and electricity derivative financial instruments that are measured at fair value on a recurring basis. The effective date for AROs that are measured at fair value on a nonrecurring basis will be January 1, 2009. FSP FAS 157-2 *"Effective Date of FASB Statement No. 157,"* issued February 12, 2008, provides a one year delay in the effective date for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value on a nonrecurring basis.

FASB No. 157 provides a new definition of fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. FASB No. 157 classifies valuation techniques into three categories: market approach, income approach and cost approach. There are two types of inputs to the valuation techniques: observable inputs based on market data obtained from independent sources, and unobservable inputs reflecting the District's own assumptions developed from the best information available in the circumstances. FASB No. 157 requires separate disclosures of assets or liabilities that are measured at fair value on a recurring basis versus items that are measured at fair value on a nonrecurring basis. The disclosures are presented in a table displaying the major categories of assets and liabilities measured at fair value, separated into the level of the hierarchy on which the fair value is based. Additional disclosure information is required for fair values based on Level 3 inputs, including a rollforward analysis and disclosure of unrealized gains and losses. These additional disclosures are provided in Note 12.

FSP FAS No. 157-3. On October 10, 2008, the FASB issued FSP FAS No. 157-3, *"Determining Fair Value of a Financial Asset When the Market for That Asset is Not Active,"* which clarifies and illustrates the application of FASB No. 157 for financial assets in an inactive market. FSP FAS 157-3 became effective upon issuance and applies to periods for which financial statements have not been issued. The District's application of FSP FAS 157-3 impacted neither the financial asset fair values nor their classification in the fair value hierarchy.

NOTE 4. UTILITY PLANT

The summarized activity of the District's utility plant during 2008 is presented below (thousands of dollars):

	Balance December 31, 2007	Additions	Transfers and Deletions	Balance December 31, 2008
Nondepreciable Utility Plant:				
Land	$ 90,250	$ 6,612	$ (3)	$ 96,859
CWIP	249,325	204,663	(216,839)	237,149
Total nondepreciable utility plant	339,575	211,275	(216,842)	334,008
Depreciable Utility Plant:				
Generation	1,373,544	18,163	(4,949)	1,386,758
Transmission	201,163	6,601	(3,025)	204,739
Distribution	1,398,068	113,328	(10,392)	1,501,004
Investment in gas properties	172,015	8,546	-0-	180,561
Investment in JPAs	10,323	1,513	-0-	11,836
General	756,663	57,864	(9,849)	804,678
	3,911,776	206,015	(28,215)	4,089,576
Less: accumulated depreciation and depletion	(1,365,821)	(158,553)	31,058	(1,493,316)
Less: accumulated amortization on JPAs	(3,209)	(313)	-0-	(3,522)
	(1,369,030)	(158,866)	31,058	(1,496,838)
Total depreciable plant	2,542,746	47,149	2,843	2,592,738
Total Utility Plant – net	$ 2,882,321	$ 258,424	$ (213,999)	$ 2,926,746

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

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 megawatt (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 $15.7 million and $13.2 million in 2008 and 2007, respectively.

Summary financial information for TANC is presented below:

	December 31, 2008 (unaudited)	December 31, 2007 (unaudited)
	(thousands of dollars)	
Total assets	$ 484,878	$ 436,804
Total liabilities	$ 476,599	$ 434,224
Total net assets	8,279	2,580
Total liabilities and net assets	$ 484,878	$ 436,804
Changes in net assets for the six months ended December 31	$ (1,919)	$ (458)

The long-term debt of TANC, which totals $357.0 million (unaudited) at December 31, 2008, 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 purchased entitlement, rights, title and interest in Vernon's COTP transmission assets (approximately 121 MW North-to-South). The assignment and transfer of Vernon's COTP entitlement occurred in April 2008. The District has received an additional 36 MW of scheduling rights, and is obligated to pay 29.8 percent of the debt associated with the Vernon purchase.

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 Cosumnes Power Plant Project, a 501 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 128 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. In January 2009, some NCGA bonds were extinguished. See Note 19 for more information on the subsequent event.

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. At December 31, 2008, $31.4 million in repurchase agreements, and at December 31, 2007 $75.3 million in commercial paper and repurchase agreements, were held by a counterparty that was acting as the District's agent in securities lending transactions.

On October 14, 2008, the Federal Deposit Insurance Corporation (FDIC) announced a temporary Transaction Account Guarantee Program, which will provide full coverage for non-interest bearing transaction deposit accounts at FDIC-insured institutions which agree to participate in the program. This unlimited insurance coverage is temporary and will remain in effect for participating institutions until December 31, 2009. Due to this temporary program, all of the District's commercial cash deposits were fully insured at December 31, 2008. The bank balance is also, per a depository pledge agreement between the District and the District's bank, collateralized at 136 percent of the collected funds on deposit (increased by the amount of accrued but uncredited interest, reduced by deposits covered by FDIC). These collateral securities are held by the District's bank in the District's name.

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, 2008	December 31, 2007
Investment Type:		
Federal National Mortgage Association (Fannie Mae)	0%	9%
Federal Home Loan Banks	8%	22%
Federal Home Loan Mortgage Corporation (Freddie Mac)	6%	5%
Morgan Stanley Repurchase Agreements	0%	8%
Banker's Acceptance – Bank of America	5%	0%
Commercial Paper – General Electric	5%	0%
CS First Boston Repurchase Agreements	5%	0%
Federal Farm Credit Bonds	5%	0%
Certificate of Deposit – US Bank	7%	0%
Certificate of Deposit – Bank of the West	5%	0%

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 2008 or 2007. The maturities of the investments made match the maturities of the securities loaned, which are U.S. Treasuries and Agencies. At December 31, 2008 and 2007, 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 in the amount of $31.4 million as of December 31, 2008. The fair market value equals the carrying amount for the Repurchase Agreements.

Interest Rate Swap Agreement. The District had 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 would have expired in June 2016. Under the terms of the swap agreement, the District paid a variable rate equal to the 90-day London Interbank Offered Rates (LIBOR) rate and receives a variable rate of the 10-year LIBOR minus 0.347 percent. [The Standard and Poor's (S&P) credit rating of the counterparty was 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, 2008 and 2007. The credit ratings listed are from S&P. (N/A is defined as not applicable to the rating disclosure requirements).

At December 31, 2008, the District's cash, cash equivalents and investments consist of the following:

Description	Credit Rating	Remaining Maturities (in years) Less Than 1	1-5	More than 5	Total Fair Value
		(thousands of dollars)			
Cash and Cash Equivalents:					
LAIF	Not Rated	$ 83,715	$ -0-	$ -0-	$ 83,715
Money Market Mutual Funds	AAAm	156,227	-0-	-0-	156,227
Certificates of Deposits	A-1	70,000	-0-	-0-	70,000
Bankers Acceptance	A-1+	31,779	-0-	-0-	31,779
Commercial Paper	A-1+	36,383	-0-	-0-	36,383
Repurchase Agreements	AAA	31,400	-0-	-0-	31,400
Corporate Note	A+	3,204	-0-	-0-	3,204
Total cash and cash equivalents		412,708	-0-	-0-	412,708
Investments:					
Fannie Mae	AAA	20,010	-0-	-0-	20,010
Federal Farm Credit Bonds	AAA	-0-	31,019	-0-	31,019
Federal Home Loan Banks	AAA/P-1	50,191	-0-	-0-	50,191
Freddie Mac	AAA/P-1	20,945	15,780	-0-	36,725
United States Treasuries	N/A	-0-	10,170	-0-	10,170
Commercial Paper	A-1+	4,997	-0-	-0-	4,997
Corporate Note	AAA/A	-0-	32,675	-0-	32,675
Total investments		96,143	89,644	-0-	185,787
Total cash, cash equivalents and investments		$ 508,851	$ 89,644	$ -0-	$ 598,495

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
			(thousands of dollars)		
Cash and Cash Equivalents:					
LAIF	Not Rated	$ 43,395	$ -0-	$ -0-	$ 43,395
Money Market Mutual Funds	AAA	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, 2008 and 2007, the District reported its book overdraft of $0.9 million and $0.1 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,	
	2008	2007
	(thousands of dollars)	
Total Cash, Cash Equivalents and Investments:		
Revenue bond reserve, debt service and construction funds:		
Revenue bond reserve fund	$ 61,285	$ 73,428
Debt service fund	52,915	53,636
Component unit bond reserve and construction funds	146,693	116,283
Total revenue bond reserve, debt service and construction funds	260,893	243,347
Nuclear decommissioning trust fund	38,333	69,865
Rate stabilization fund	74,775	91,143
Securities lending collateral	31,400	75,284
Other restricted funds	805	803
Unrestricted funds	192,289	169,922
Total cash, cash equivalents and investments	$ 598,495	$ 650,364

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 (Costs)

Decommissioning. The District's regulatory asset relating to the unfunded portion of its decommissioning liability is being collected through interest earnings on the Trust Fund. 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 relating to its wholesale receivables that were fully reserved as uncollectible in 2001. These wholesale receivable reserves relate to amounts due from the California Power Exchange totaling $24.6 million and $24.2 million at December 31, 2008 and 2007, 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. 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.

Derivative Financial Instruments. The District's regulatory costs and/or credits relating to derivative financial instruments are 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.

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.

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

	December 31, 2008	December 31, 2007
	(thousands of dollars)	
Regulatory Costs for Future Recovery:		
Decommissioning	$ 143,622	$ 137,998
Wholesale power receivables	24,582	24,242
TANC operations costs	10,572	6,571
U.S. Bureau of Reclamation	5,508	6,200
Derivative financial instruments	181,687	-0-
Enrichment facility decommissioning assessment	-0-	1,215
Total regulatory costs	365,971	176,226
Less: regulatory costs to be recovered within one year	(98,363)	(39,464)
Total regulatory costs for future recovery – net	$ 267,608	$ 136,762

Regulatory Liabilities (Credits)

CIAC. In 2008 and 2007 the District capitalized CIAC totaling $19.0 million and $24.4 million, respectively, in Plant in Service in the Consolidated Balance Sheets and recorded $8.1 million and $7.6 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.

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.

Hydro Rate Stabilization. In May 2008, the Board approved a Hydro Generation Adjustment (HGA) mechanism effective July 1, 2008. The HGA will automatically adjust rates in April each year based on the precipitation results from the previous April 1 through March 31. The increase or decrease in rates will be limited to a maximum rate change of four percent. The HGA also established a Hydro Rate Stabilization Fund (HRSF) with the transfer of $30.0 million from the Rate Stabilization Fund. In 2008, $15.0 million from the HRSF was recognized as revenue to cover the budget impact of low precipitation.

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.

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.

Litigation Settlement. During 2008, the District received several payments related to a natural gas antitrust litigation settlement. Of the total received, $16.5 million was deferred to be recognized as revenue in 2009 per Board resolution.

Senate Bill 1. During 2007, the District implemented a solar surcharge of $0.001 per kilowatt hour, effective January 1, 2008. The surcharge was implemented in order to fund investments in solar required by Senate Bill 1 (SB-1). The difference between the surcharge revenues received and the funds spent on solar initiatives will be deferred into future years. In 2008, the District spent less than it collected in SB-1 revenues, and has recorded a regulatory credit.

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

	December 31, 2008	December 31, 2007
	(thousands of dollars)	
Regulatory Credits for Future Revenue Recognition:		
CIAC	$ 219,570	$ 208,733
Derivative financial instruments	-0-	79,354
Rate stabilization	59,775	91,143
Hydro rate stabilization	15,000	-0-
Precipitation hedges	-0-	10,696
Public good	928	2,097
Litigation settlement	16,468	-0-
SB-1	7,722	-0-
Total regulatory credits for future revenue recognition	319,463	392,023
Less: regulatory credits to be recognized within one year	(31,018)	(31,037)
Total regulatory credits – net	$ 288,445	$ 360,986

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 2008 and 2007, 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, 2008	December 31, 2007
	(thousands of dollars)	
Derivative Financial Instrument Assets:		
Gas related agreements	$ 24,749	$ 81,806
Electric related agreements	1,037	2,068
Treasury related agreements	37,056	27,050
Total derivative financial instrument assets	62,842	110,924
Less: derivative financial instruments maturing within one year	(10,222)	(22,870)
Total derivative financial instrument assets – net	$ 52,620	$ 88,054
Derivative Financial Instrument Liabilities:		
Gas related agreements	$ 177,328	$ 5,319
Electric related agreements	9,475	3,307
Treasury related agreements	54,885	19,920
Total derivative financial instrument liabilities	241,688	28,546
Less: derivative financial instruments maturing within one year	(82,934)	(10,344)
Total derivative financial instrument liabilities – net	$ 158,754	$ 18,202

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, 2008.

NOTE 10. LONG-TERM DEBT

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

	December 31, 2008	December 31, 2007
	(thousands of dollars)	
Electric Revenue Bonds:		
Electric revenue bonds, 2.5%-6.5%, 2009-2033	$ 1,814,480	$ 1,544,425
Subordinated electric revenue bonds, 0.6%-8.0%, 2009-2028	222,425	443,400
Total electric revenue bonds	2,036,905	1,987,825
Component unit project revenue bonds, 3.0%-5.25%, 2009-2030	519,205	541,390
Gas supply prepayment bonds 3.85%-5.0%, 2008-2027	738,390	757,055
Total long-term debt outstanding	3,294,500	3,286,270
Bond premiums – net	93,303	73,074
Deferred losses on bond refundings - net	(78,857)	(79,763)
Total long-term debt	3,308,946	3,279,581
Less: amounts due within one year	(103,845)	(106,365)
Total long-term debt – net	$ 3,205,101	$ 3,173,216

The summarized activity of the District's long-term debt during 2008 is presented below (thousands of dollars):

	December 31, 2007	Additions	Payments or Amortization	December 31, 2008	Amounts Due Within One Year
			(thousands of dollars)		
Electric revenue bonds	$ 1,544,425	$ 521,730	$ (251,675)	$ 1,814,480	$ 65,835
Subordinate electric revenue bonds	443,400	197,850	(418,825)	222,425	-0-
Component unit project revenue bonds	541,390	-0-	(22,185)	519,205	13,925
Gas supply prepayment bonds	757,055	-0-	(18,665)	738,390	24,085
Total	3,286,270	719,580	(711,350)	3,294,500	$ 103,845
Unamortized premiums – net	73,074	29,118	(8,889)	93,303	
Deferred losses on bond refundings – net	(79,763)	(43,976)	44,882	(78,857)	
Total long-term debt	$ 3,279,581	$ 704,722	$ (675,357)	$ 3,308,946	

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, 2006	Amounts Due Within One Year
			(thousands of dollars)		
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	

At December 31, 2008 scheduled annual principal maturities and interest are as follows (thousands of dollars):

	Principal	Interest	Total
2009	$ 103,845	$ 150,240	$ 254,085
2010	121,240	145,126	266,366
2011	100,850	138,513	239,363
2012	107,025	133,313	240,338
2013	124,590	128,286	252,876
2014 – 2018 (combined)	778,000	544,966	1,322,966
2019 – 2023 (combined)	961,005	351,060	1,312,065
2024 – 2028 (combined)	868,820	144,205	1,013,025
2029 – 2033 (combined)	129,125	14,976	144,101
Total Requirements	$ 3,294,500	$ 1,750,685	$ 5,045,185

Interest in the preceding table includes interest requirements for fixed rate debt at their stated rates, variable rate debt covered by interest rate swaps at their fixed rate, and variable rate debt not covered by interest rate swaps using the debt interest rate of 0.60 and 0.75 percent in effect at December 31, 2008 for the issue.

2008 Revenue Bonds Refunding and Redemptions. In March 2008, the District redeemed $12.0 million of SMUD 2001 Sub Series B Bonds. This bond redemption resulted in a current accounting loss of $0.1 million, 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 $12.1 million.

In June 2008, the District issued $521.7 million of 2008 Series U Electric Revenue Refunding Bonds. A portion of the proceeds from the 2008 Series bonds and $11.4 million of available funds were used to refund $397.9 million of previously issued 1996, 1997, 2002, and 2003 District Bonds and accordingly, the liability for the extinguished bonds has been removed from Long-Term Debt in the Consolidated Balance Sheets. In addition to refunding fixed rate debt, proceeds from the Series U Bonds were also used to refund variable rate Auction Rate Securities (ARS). The ARS had begun to experience failed auctions due to market disruptions. If the failed auctions persisted, the District estimates the potential economic gain could be as much as $20.0 million over the remaining life of the ARS. Because there is no certainty as to whether the failed auctions would continue, or for how long they would continue, the District opted to refund this portion of the ARS with fixed rate debt in order to bring more certainty to the budget and rate planning process. The refunding resulted in the recognition of a deferred accounting loss of $5.5 million, which is being amortized over the life of the refunding issue. The 2008 refunding increased future aggregate debt service payments by $22.4 million but resulted in a total economic gain of $23.6 million, the difference between the present value of the old and new debt service payments. The economic gain on the refunding was measured on a present value basis, consequently differences in the timing of debt service payments resulted in positive savings despite the nominal increase in debt service. Proceeds from the bonds were also used to fund $150.0 million of capital expenditures.

In July 2008, SCA redeemed $8.8 million of SCA 1998 Revenue Bonds. This bond redemption resulted in a current accounting loss of $0.2 million, 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 $9.5 million.

In August 2008, the District issued $120.0 million of 2008 Series J and $77.9 million of 2008 Series K Subordinated Electric Revenue Refunding Bonds. Proceeds from the 2008 Series bonds and $2.3 million of available funds were used to refund $198.8 million of previously issued 1997, 2001, 2002, and 2003 District Bonds and accordingly, the liability for the extinguished bonds has been removed from Long-Term Debt in the Consolidated Balance Sheets. The refunding resulted in the recognition of a deferred accounting loss of $3.5 million, which is being amortized over the life of the refunding issue. The District refunded both fixed rate bonds and ARS with the issuance of Series J and K. The 2008 refunding reduced future aggregate debt service payments by $56.1 million and resulted in a total economic gain, which is the difference between the present value of the old and new debt service payments, of $4.3 million on the fixed rate bonds, and $34.8 million on the ARS.

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.

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

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

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 (1.25 percent at December 31, 2008) 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 originally entered into for the purpose of fixing the effective interest rate associated with certain of its subordinated bonds that were refunded during 2008. 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. The obligations of the District under the swap agreements are not secured by a pledge of revenues of the District's electric system or any other property of the District.

Component Unit Interest Rate Swap Agreements. NCGA has four swap agreements, which are summarized as follows:

Initial Notional Amount	Agency Pays	Fixed Rate	Floating Rate	Termination Date	Credit Support Provider Credit Rating (S&P)
$ 43,770	Fixed	3.851%	67% of LIBOR+.45%	07/01/13	A
100,385	Fixed	4.062%	67% of LIBOR+.60%	07/01/17	A
65,865	Fixed	4.144%	67% of LIBOR +.63%	07/01/19	A
458,450	Fixed	4.304%	67% of LIBOR +.72%	07/01/27	A

In May 2007, NCGA entered into four variable-to-fixed interest rate swap agreements with a counterparty for the purpose of fixing the effective interest rate associated with the 2007 Series B Bonds. NCGA pays the counterparty a fixed rate on the notional amount and receives a floating rate equal to 67 percent of the three month LIBOR plus an interest rate spread, as specified in each swap agreement. The total notional amounts of the four swaps at December 31, 2008 was $668.5 million and was equivalent to the outstanding principal balance on the NCGA 2007 Series B Bonds. The swaps are amortized over the life of their respective swap agreements in a manner corresponding to the principal repayment schedule of the 2007 Series B Bonds. Early termination of the swaps would occur upon termination of the prepaid agreement for any reason. Upon early termination, the swaps would have no value to either party.

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 weekly rates, ranging from 0.60 percent to 0.75 percent at December 31, 2008. The District can elect to change the interest rate period or fix the interest rate, with certain limitations. The District's Variable Rate Bonds can be put to the District's Trustee by the bondholders, however the District has in place a reimbursement agreement with Bank of America to enable the District to pay off the bonds over five years if the bonds are put. 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 $222.4 million of Electric System Revenue Bonds that are currently callable, all of which is subordinate debt and is composed of $24.5 million of fixed rate debt and $197.9 million of Variable Rate Demand Notes (VRDN's). The District has $1,200.9 million of bonds that become callable from 2011 through 2018, and these bonds can be called until maturity.

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 District's electric system. 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.

GASB No. 48. The District has pledged future net electric revenues, component unit net project revenues, and net gas supply prepayment revenues to repay $3,294.5 million and $3,286.3 million at December 31, 2008 and 2007, respectively, in electric revenue, component unit project revenue and gas supply prepayment revenue bonds issued from 1992 through 2008. Proceeds from the bonds provided financing for various capital improvement projects, component unit capital projects, and the prepayment of a twenty-year supply of natural gas. The bonds are payable solely from the net revenues generated by the District's electrical sales, component unit project revenues, and gas supply prepayment revenues and are payable through 2033 at December 31, 2008 and 2007. Annual principal and interest payments on the bonds are expected to require approximately 35 percent of net revenues for the years ending December 31, 2008 and 2007, respectively. The total principal and interest remaining to be paid on the bonds is $5,045.2 million and $5,067.3 million at December 31, 2008 and 2007, respectively. Principal and interest paid was $250.0 million for 2008, and $231.4 million for 2007. Total net revenues were $722.6 million for 2008 and $661.0 million for 2007.

NOTE 11. COMMERCIAL PAPER NOTES

The District issues Commercial Paper Notes (Notes) to finance or reimburse capital expenditures. At December 31, 2008 Notes outstanding totaled $200.0 million, and as of December 31, 2007, there were $150.0 million in Notes outstanding. The effective interest rate for the Notes outstanding at December 31, 2008 was 1.628 percent and the average term was 93 days. On January 23, 2007, a new $204.9 million letter of credit went into effect. There has not been a term advance under the letter of credit agreement.

The summarized activity of the District's Notes during 2008 and 2007 is presented below (thousands of dollars):

	Balance at beginning of Year	Additions	Reductions	Balance at end of Year
December 31, 2008	$ 150,000	$ 50,000	$ -0-	$ 200,000
December 31, 2007	$ -0-	$ 150,000	$ -0-	$ 150,000

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. For 2008, due to the current economic conditions, the weakened financial condition of bond insurers, and general market disruptions, the yield curve for insured municipal bonds was not used for the District's debt. The District's electric revenue bonds were instead valued at the yield curve for "A" rated municipal power bonds. For the same reasons, the yield curve for "BBB" rated municipal power bonds was used for insured component unit bonds instead of the "A" ratings used in past years. The yield curve for "A" rated finance bonds was used for NCGA debt, reflecting the downgrade of Morgan Stanley in 2008. For 2007, 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 values provided by counterparties.

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.

The estimated fair values of the District's financial instruments are presented below. Market values may have changed significantly since December 31, 2008.

	December 31, 2008	
	Recorded Value	Fair Value
	(thousands of dollars)	
Investments, including cash and cash equivalents	$ 598,495	$ 598,495
Long-term debt	(3,308,946)	(3,278,766)
Interest rate swap and put agreements – net	(17,829)	(17,829)
Gas and electricity related derivatives – net	(161,017)	(161,017)

	December 31, 2008	
	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 – net	7,130	7,130
Gas and electricity related derivatives – net	75,248	75,248

Fair Value Measurements. Effective January 1, 2008, the District adopted FASB No. 157 as discussed in Note 3, which, among other things, requires enhanced disclosures about assets and liabilities carried at fair value. FASB No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The District utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. The District primarily applies the market approach for recurring fair value measurements, maximizing the use of observable inputs and minimizing the use of unobservable inputs. SFAS No. 71 allows the District to defer the unrealized gains and losses associated with these derivative financial instruments as they are expected to be reflected in rate-making actions of the Board (see Notes 8 and 9).

The District values natural gas and electricity derivatives based on monthly quoted prices from an independent external pricing service. When external quoted market prices are not available for derivative contracts, the District uses an internally developed valuation model utilizing short-term observable inputs.

FASB No. 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy defined by FASB No. 157 are as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities at the reporting date. An active market is a market in which the transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of natural gas and electricity derivative financial instruments for which prevailing market quotes in active markets (i.e., Henry Hub and So Cal) for identical contracts are available.

Level 2 – Pricing inputs that are other than quoted prices included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. Level 2 fair values for natural gas and electricity derivative financial instruments are calculated based on forward curves that are derived from observable market data based on delivery point by correlation and other means, such as seasonality, and extrapolation beyond available market quotes. Level 2 fair values for interest rate swap agreements are calculated by swap pricing models on the basis of the prevailing swaps' yield curve and discounting cash flows at their corresponding zero coupon rate.

Level 3 – Pricing inputs that are unobservable for the asset or liability for which there is little, if any, market activity as of the reporting date. These inputs may be used with internally developed methodologies that result in the District's best estimate of fair value. Level 3 fair values for natural gas derivative financial instruments are calculated based on a model which extrapolates out short-term observable inputs through use of regression analysis and normalization factors to provide a multi-year monthly price forecast.

The following table sets forth by level within the fair value hierarchy the District's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2008. As required by FASB No. 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The District's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value assets and liabilities and their placement within the fair value hierarchy levels.

Recurring Fair Value Measures

	At fair value as of December 31, 2008			
	Level 1	Level 2	Level 3	Total
	(thousands of dollars)			
Derivative Financial Instrument Assets:				
Gas related agreements	$ 5,507	$ 1,664	$ 17,578	$ 24,749
Electric related agreements	-0-	1,037	-0-	1,037
Treasury related agreements	-0-	37,056	-0-	37,056
Total Derivative Financial Instrument Assets	$ 5,507	$ 39,757	$ 17,578	$ 62,842
Derivative Financial Instrument Liabilities:				
Gas related agreements	$ 173,270	$ 233	$ 3,825	$ 177,328
Electric related agreements	-0-	9,475	-0-	9,475
Treasury related agreements	-0-	54,885	-0-	54,885
Total Derivative Financial Instrument Liabilities	$ 173,270	$ 64,593	$ 3,825	$ 241,688

The following table provides a reconciliation of changes in the fair value of net natural gas derivatives classified as Level 3 in the fair value hierarchy from the table above as of December 31, 2008.

	Gas Related Agreements
	(thousands of dollars)
Derivative Financial Instrument	
Asset balance as of January 1, 2008 – net	$ 44,438
Purchases and settlements	(2,845)
Realized and unrealized gains (losses):	
Included in regulatory assets and liabilities	(27,840)
Transfers in (out) of Level 3	-0-
Derivative Financial Instrument	
Asset balance as of December 31, 2008 – net	$ 13,753

Net assets for the period were not impacted by unrealized gains or (losses) relating to assets or liabilities still held at December 31, 2008. The District did not have any nonrecurring financial measurements that are within the scope of FASB No. 157 as of December 31, 2008.

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 with the first phase of physical work completed 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 2009 after the NRC verifies that the facility is suitable for license termination. The waste remaining on site after the first phase will be stored for an unspecified period 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 2008 study. The ARO estimate assumes all spent nuclear fuel will be removed from the site by 2028.

Rancho Seco's ARO is presented below:

	December 31, 2008	December 31, 2007
	(thousands of dollars)	
Active decommissioning	$ 52,466	$ 75,547
Spent fuel management	118,926	116,197
Total ARO	$ 171,392	$ 191,744
Less: current portion	(6,913)	(42,292)
Total Non-current portion of ARO	$ 164,479	$ 149,452

The summarized activity of the Rancho Seco ARO during 2008 and 2007 are presented below. 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, 2008	December 31, 2007
	(thousands of dollars)	
ARO at beginning of year	$ 191,744	$ 247,479
Accretion	8,475	10,367
Expenditures	(30,677)	(55,109)
Annual adjustments	1,850	(10,993)
Total ARO	$ 171,392	$ 191,744

The District contributed $2.6 million to the Trust Fund in 2008 and $27.0 million in 2007.

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 2008 were $28.0 million. The Annual Pension Cost for 2008 was $27.4 million, and $0.6 million was paid by employees for purchase of additional service credits. Overall, the District paid $26.8 million, and employees paid $1.2 million. 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. 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 2008 was determined by PERS as part of the annual actuarial valuation as of June 30, 2005; the contribution for the second half of 2008 was determined by PERS as part of the annual actuarial valuation as of June 30, 2006. 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 fifteen-year period (smoothed market value).

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

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contribution
6/30/08	$ 27,405	100%
6/30/07	$ 24,225	100%
6/30/06	$ 20,825	100%

Funded Status and Funding Progress. As of June 30, 2007, the most recent actuarial valuation date, the plan was 98.9 percent funded. The actuarial accrued liability for benefits was $1,315 million, and the actuarial value of assets was $1,301 million, resulting in an unfunded actuarial accrued liability (UAAL) of $14.6 million. The covered payroll (annual payroll of active employees covered by the plan) was $171.3 million, and the ratio of the UAAL to the covered payroll was 8.5 percent. The schedule of funding progress, presented as Required Supplementary Information (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 $16.0 million and $1.5 million in 2008, respectively, and $15.9 million and $1.5 million in 2007, 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. 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 retirees hired before January 1, 1991, and a portion of the cost based on credited years of service for retirees hired after January 1, 1991. The District also contributes a portion of the costs of coverage for these retirees' dependents. Retirees are required to contribute the portion that is not paid by the District. The benefits, benefit levels, retiree 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, 2008, 2,572 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 was effective for the District beginning in 2007 and the District has implemented GASB No. 45 prospectively.

In October 2007, the Governor of California signed Assembly Bill 554 (AB 554) into law. AB 554 allowed California public employers to join the California Employers Retiree Benefit Trust (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.

GASB No. 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. 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.

In 2008, the District funded its 2008 net ARC to the CERBT trust. The District's contract with PERS requires net OPEB funding, so the contribution in 2008 was the ARC less the estimated cash flow for retiree benefit costs for 2008. The District then made the actual payments for retiree medical costs. During 2007, the District recorded postemployment healthcare benefit contributions based on when the payment was made. During 2008, postemployment healthcare benefit contributions to PERS were $22.9 million, which was made up of the 2007 ARC less actual 2007 medical payments, plus estimated interest for 2007, and the 2008 ARC less the estimated 2008 medical expenses. The District had not joined the CERBT plan in 2007, and thus, had no contributions. During 2008 and 2007, the District made the following healthcare benefit contributions by paying actual medical costs of $11.6 and $9.8 million, respectively.

Funding Status and Funding Progress. At December 31, 2008 and 2007, the District estimates that the actuarially determined accumulated postemployment benefit obligation was approximately $264.0 million and $248.7 million, respectively. The plan was 8.7 percent funded at December 31, 2008 and not funded in 2007.

The covered payroll (annual payroll of active employees covered by the plan) is $199.4 million. The ratio of the UAAL to covered payroll is 121 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 each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. For 2008, the District's annual OPEB Cost (expense) of $19.6 million was equal to the ARC.

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

	Year Ended December 31, 2008	2007
	(thousands of dollars)	
Annual required contribution	$ 19,589	$ 23,695
Interest on net OPEB obligation	1,075	-0-
Adjustment to annual required contribution	-0-	-0-
Annual OPEB cost (expense)	20,664	23,695
Contributions made	34,529	9,830
Increase in net OPEB obligation	(13,865)	13,865
Net OPEB obligation, beginning of year	13,865	-0-
Net OPEB obligation, end of year	$ -0-	$ 13,865

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2008 is as follows:

Year Ending	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
December 31, 2008	$ 19,589	176%	-0-
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, 2008 and 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 CERBT. 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 had not advance funded its obligation in 2007.

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 RSI 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 $5 thousand 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, and in some cases, some coverage increases in 2008. In 2008, 2007 and 2006, 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, 2008, 2007, and 2006 is presented below:

	2008	2007	2006
		(thousands of dollars)	
Workers' compensation claims	$ 7,066	$ 6,434	$ 5,862
General and auto claims	761	1,410	2,004
Short- and long-term disability claims	79	1,621	1,247
Claims liability	$ 7,906	$ 9,465	$ 9,113

Changes in the District's total claims liability during 2008, 2007 and 2006 is presented below:

	2008	2007	2006
		(thousands of dollars)	
Claims liability, beginning of year	$ 9,465	$ 9,113	$ 9,372
Add: provision for claims, current year	3,111	2,123	2,180
Increase/(Decrease) in provision for claims in prior years	(470)	2,264	2,032
Less: payments on claims attributable to current & prior years	(4,200)	(4,035)	(4,471)
Claims liability, end of year	$ 7,906	$ 9,465	$ 9,113

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, 2008, the approximate minimum obligations for these contracts over the next five years are as follows:

Year ending:	Amount
	(thousands of dollars)
2009	$ 245,991
2010	211,988
2011	178,220
2012	155,412
2013	144,151

Contractual Commitments beyond 2013. Several of the District's purchase power contracts extend beyond the five-year summary presented above. These contracts expire between 2014 and 2026 and provide for power under various terms and conditions. The District estimates its annual minimum commitments under these contracts range between $138.6 million in 2014 and $0.4 million in 2028. 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 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 784,300 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 $108.50 per MWh. The swap agreements expire periodically from January 2009 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 was renewed in 2009 and expires in 2011.

At December 31, 2008, the approximate minimum obligations for these natural gas related contracts over the next five years are as follows:

Year ending:	Amount (thousands of dollars)
2009	$ 108,828
2010	84,814
2011	75,321
2012	72,623
2013	72,623

Contractual Commitments beyond 2013. Several of the District's gas transport and gas storage contracts extend beyond the five-year summary presented above. These contracts expire between 2014 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 $29.5 million in 2014 and $3.9 million in 2023.

Gas Price Swap Agreements. The District has entered into numerous variable to fixed rate swaps with notional amounts totaling 180,539,000 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 $6.30 to $12.41 per mmbtu. The swap agreements expire periodically from January 2009 through December 2022.

NOTE 18. CLAIMS AND CONTINGENCIES

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.

The Ninth Circuit found that the FERC does not have refund jurisdiction over municipal utilities for sales made during the California energy crisis, and that decision is now final. Therefore, the District has no refund liability.

On December 18, 2008, the FERC issued an order finding that the District and other governmental entities were properly designated as non-public utilities and directed the ISO and the PX to release the governmental entities collateral within 20 days of the issuance of the order. On January 7, 2009, the District received its collateral back with interest from the PX in the amount of $1.1 million.

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 arguing that the billing was inconsistent with the Restated Interim Agreement, the primary agreement between the parties governing such transactions and, therefore, no Replacement Reserve charges are due. 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 balancing authority. 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 estimates its maximum liability for this matter at $2.2 million; however, District management believes that it is not likely that it will 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 sought 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 included emissions costs, start-up costs, and minimum load costs (Must Offer costs). PG&E disputed 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, and 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. On May 15, 2008, the FERC denied the ISO's petition for review, and granted PG&E's request for interest. The time for the ISO to challenge the May 15, 2008 FERC decision has passed; the order is now final and the matter is closed.

Claims for 2000 and 2001 Power Sales. On December 6, 2005, PG&E, 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 (Refund Period) 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. On January 15, 2008, the Governmental Entities filed an answer to the California Parties' complaint. The parties served the first round of discovery in early June 2008. On October 6, 2008, an initial status conference was held. Citing a conflict of interest, several of the Defendants filed motions to disqualify one of the law firms representing the Plaintiffs. A disqualification hearing was held on December 4, 2008, during which the Judge issued an order disqualifying PG&E's law firm from the case based on concurrent representation conflicts. A status conference was held on January 22, 2009.

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. In a related matter, the Ninth Circuit determined that FERC lacked jurisdiction to order non-jurisdictional entities, including the District, to pay refunds for wholesale power sales. 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 $13.5 million. Ultimately, the District believes the claim to be both untimely and without merit, and does not believe that the California Parties will be successful in pursuing the claim.

In a closely rated matter, 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 during the Refund Period, as well as the District's bilateral power sales to the Department of Water Resources (DWR) through the California Energy Resource Scheduler (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 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 during the Refund Period. 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 Cosumnes Power Plant (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. 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 the District'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 to the Court of Appeal. On September 25, 2007, the California Supreme Court denied Fru-Con's attempt to overturn the Court of Appeal's decision upholding the Superior Court's order.

In 2008, the Federal District Court took the federal trial off calendar, and scheduled a status conference in 2009, after the completion of the Superior Court trial, which commenced on January 26, 2009.

The Judge recently ruled on several pre-trial motions, the most significant of which prohibits Fru-Con from presenting evidence or argument that the District wrongfully terminated Fru-Con. The ruling explained that the District properly terminated Fru-Con for cause and that the District is entitled to recover damages, and as such, no evidence to the effect that the District wrongfully terminated the contract is relevant or admissible.

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

On January 30, 2009, NCGA partially terminated the Prepaid Agreement in return for a cash payment of $19.7 million from MSCG to NCGA and a corresponding reduction in future gas deliveries to NCGA. MSCG accomplished the partial termination by purchasing $250 million of the 2007 Series B Gas Project Revenue Bonds and presenting the Bonds to the Trustee for extinguishment. All of the agreements associated with the Gas Project were amended to accommodate the reduction in debt and gas delivery requirements. Future natural gas deliveries will be reduced by approximately 33 percent.

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 (thousands of dollars):

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)
6/30/07	$ 1,300,814	$ 1,315,424	$ 14,611	98.9%	$ 171,285	8.5%
6/30/06	$ 1,213,295	$ 1,226,029	$ 12,734	99.0%	$ 163,744	7.8%
6/30/05	$ 1,143,666	$ 1,141,187	$ (2,478)	100.2%	$ 158,557	(1.6%)

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

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	$ 22,923	$ 263,982	$ 241,059	8.7%	$ 199,369	121%
1/1/2007	$ -0-	$ 248,691	$ 248,691	0%	$ 186,000	134%
1/1/2006	$ -0-	$ 262,546	$ 262,546	0%	$ 186,000	141%

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