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

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

DPG 10-125

June 2, 2010

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

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

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

ANNUAL FINANCIAL REPORT

Attention: John Hickman and Christopher Staab

In accordance with 10 CFR 50.71(b) and 10 CFR 72.80(b), we are submitting the 2009 annual financial report for the Sacramento Municipal Utility District. If you or members of your staff have questions requiring additional information or clarification, please contact me at (916) 732-4817.

Sincerely,

Einar Ronningen
Superintendent, Rancho Seco Assets

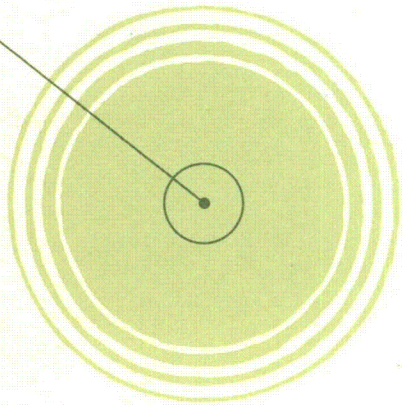
Cc: NRC, Region VI

M 004
NMSS01

SMUD
SACRAMENTO MUNICIPAL UTILITY DISTRICT

2009 Annual Report

Connecting me to
smarter energy choices.



Community Value

Innovation | Partnerships | Cleaner Energy Mixes

Statistics 2009

Service area population
1.4 million

Total operating budget
$1.3 billion

Employees (year end)
2,113

Record peak demand
3,299 megawatts
(July 24, 2006)

Number of customers (year end)
595,076

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

Executive Management

John DiStasio
General Manager &
Chief Executive Officer

Arlen Orchard
General Counsel

James A. Tracy
Chief Financial Officer

James R. Shetler
Assistant General Manager,
Energy Supply

Paul Lau
Assistant General Manager,
Customer, Distribution & Technology

Gary King
Chief Workforce Officer

Elisabeth Brinton
Chief Business & Public Affairs Officer

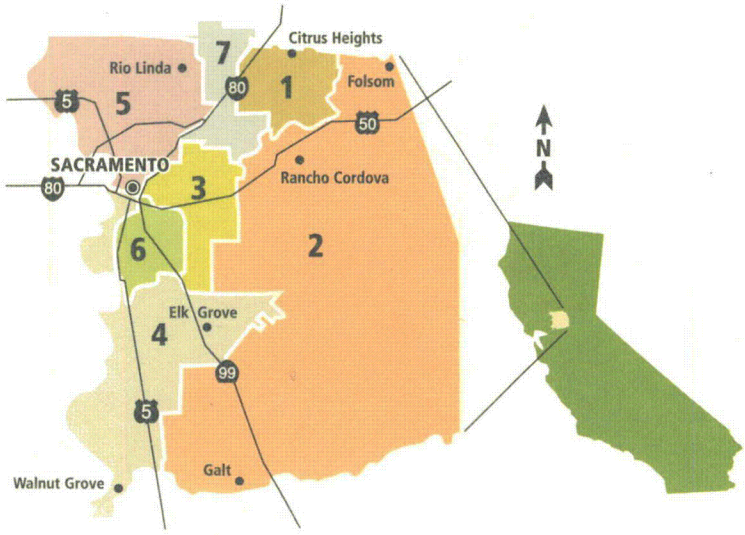
Michael Gianunzio
Chief Legislative & Regulatory
Affairs Officer

Noreen Roche-Carter
Treasurer

Cary M. Nethaway
Controller

SMUD Service Area and Board Member Wards

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



SMUD Board of Directors

Renee Taylor
Ward 1
(Vice President 2010)

Nancy Bui-Thompson
Ward 2

Howard Posner
Ward 3
(President 2009)

Genevieve Shiroma
Ward 4
(President 2010)

Rob Kerth
Ward 5

Larry Carr
Ward 6

Bill Slaton
Ward 7
(Vice President 2009)

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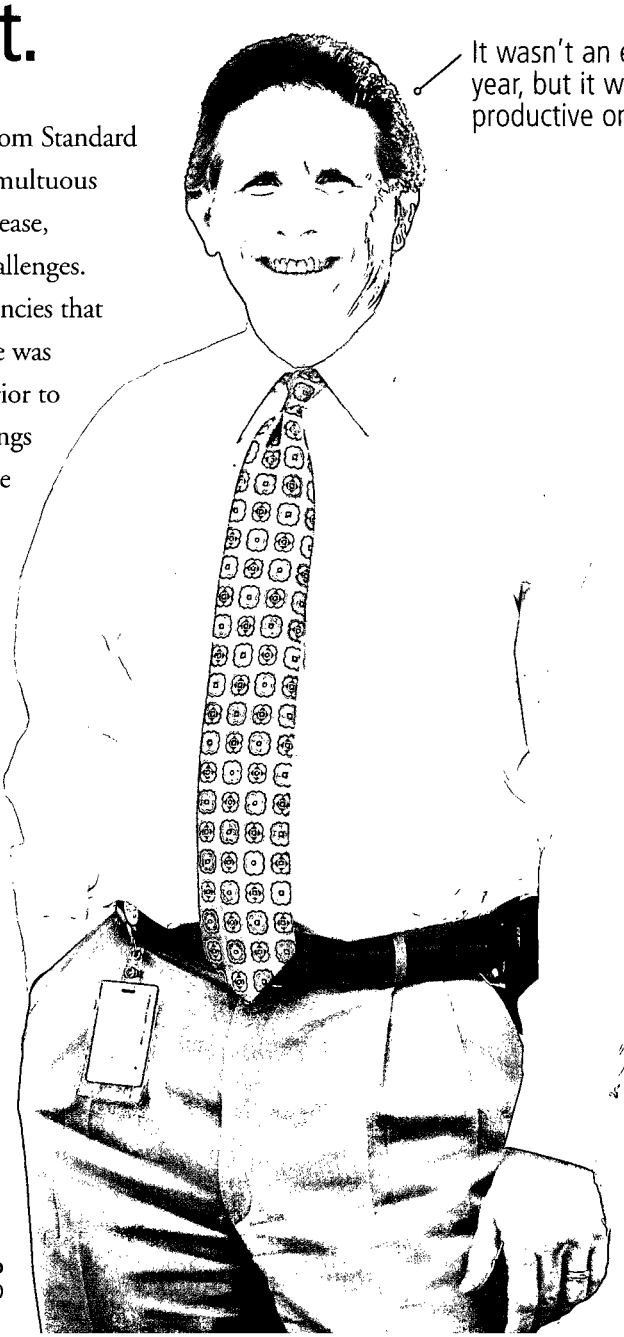
Produced by: Communications, Marketing and Community Relations

General manager's letter

Despite so much economic uncertainty, SMUD kept its financial house in order in 2009. In fact, it was a year of progress. SMUD continued to increase its renewable energy portfolio and began a district-wide project to install "smart" meters that will give each of nearly 600,000 customers more control over their energy decisions. It wasn't an easy year, but it was a productive one.

Now more than ever, SMUD must not lose sight of its core values – not just affordability and reliability but also accountability, responsiveness and trust.



It wasn't an easy year, but it was a productive one.

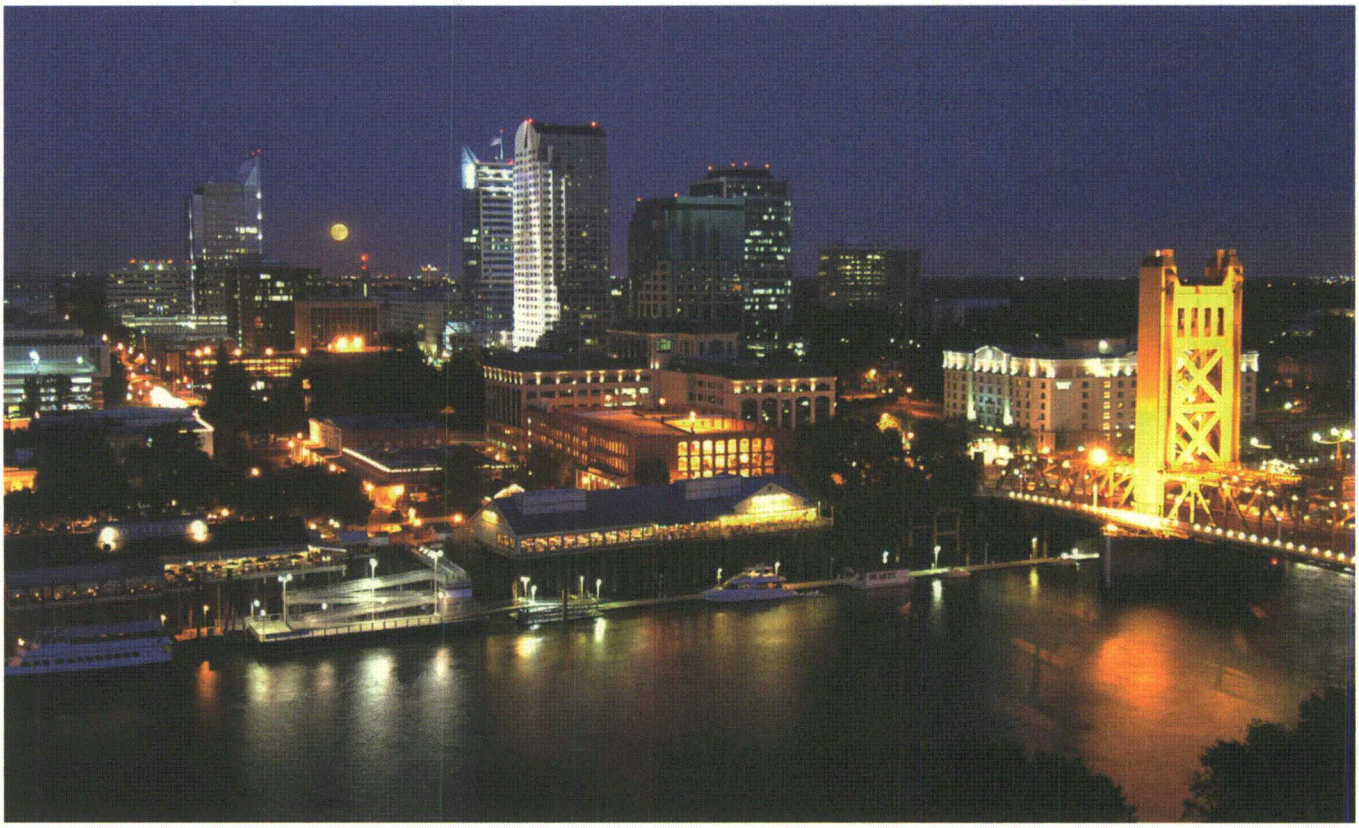
SMUD met its budget goals for 2009 and received a credit upgrade from Standard & Poor's to A+, a particularly noteworthy development in such a tumultuous economic climate. We enacted the first stage of a three-part rate increase, necessitated by the convergence of a variety of external economic challenges. This was a difficult step to take, but it signaled to the credit-rating agencies that SMUD has a sound business plan and good governance. The rate hike was made only after SMUD reduced its operating costs by $30 million. Prior to implementing the increase, we held more than 100 community meetings and responded to the request of business customers to split the increase into three steps to smooth the impact on the community.

Now more than ever, SMUD must not lose sight of its core values – not just affordability and reliability but also accountability, responsiveness and trust. Sacramento residents created SMUD more than 60 years ago because they wanted a voice in the energy decisions that would shape their community's future. As we navigate through these challenges and keep our customers' best interests front and center, SMUD must always deliver on the value that the community envisioned when SMUD was created in the first half of the 20th century.

In 2009, SMUD received the highest customer satisfaction scores of any large California utility for the eighth year in a row. Our national reputation received a major boost when SMUD was awarded a $127.5 million infrastructure grant from the

Continued on page 2

John DiStasio
General Manager/CEO



General manager's letter – continued

U.S. Department of Energy to expedite the implementation of a "smart grid" In the project we're calling SmartSacramento, SMUD will team with three regional partners – California State University, Sacramento, Los Rios Community College District and the California Department of General Services – to bring the benefits of the smart grid to Sacramento much sooner than would have been possible without the stimulus dollars.

SMUD supports and promotes our community's values. I hope you take the time to read about some of the ways in which we follow through on our responsibility to the community – through partnerships, innovation and environmental stewardship. In 2010, we'll continue installing smart meters to create the foundation for a smarter grid that will give customers more control of their energy use while improving local air quality.

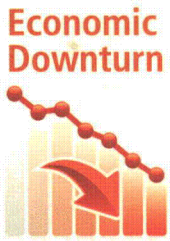
This national transition to a greener economy is SMUD's leadership moment. We're ready for the challenge – and the opportunity.

Sincerely,

John DiStasio
General Manager/CEO

Year in review

The recession continued to batter the Sacramento economy in 2009. Regional unemployment climbed above 12 percent. Local, state and federal agencies were forced to implement unpaid furloughs and layoffs. Requests for new electric service from SMUD hit an all-time low. Practically everyone living in the Sacramento region feels the effects of the economic downturn in one way or another.



There was plenty of good news at SMUD in 2009.

But there was some decidedly good news at SMUD in 2009, highlighted by two major votes of confidence that should benefit SMUD customers for years and decades to come.

Residential Rate Comparison

California Utilities Average Monthly Residential Electric Bills @ 750 kWh
Effective March 1, 2010

Utility	Monthly Bill	% Difference
SMUD	$ 88.72	—
Roseville Electric	$ 95.58	7.2%
L.A. Department of Water & Power	$ 96.18	7.8%
PG&E	$ 119.97	26.0%
San Diego Gas & Electric	$ 128.43	30.9%
Southern California Edison	$ 128.85	31.1%

Standard & Poor's upgraded its opinion of SMUD's credit worthiness from A to A+, signaling to the investment world that SMUD has a sound business strategy. The upgrade was particularly noteworthy in light of the rash of credit downgrades across the financial sector. In issuing the upgrade, Standard & Poor's noted that SMUD is ahead of most utilities in addressing climate change and is taking steps to protect its cash flow.

The benefit of the upgrade was seen in early May when SMUD sold $200 million worth of bonds. Thanks to interest rates that were lower than the alternative municipal bonds, the sale will save SMUD about $57 million over the 27-year life of the bonds.

The credit upgrade was due in part to a proposed rate increase that was implemented in September 2009. At the suggestion of the business community, the SMUD Board of Directors chose to spread out the increase into three steps – of 5.5 percent, 5.5 percent and 2.25 percent – over 16 months to ease its effects on business and residential customers.

SMUD is always reluctant to raise rates, but this change was needed to shore up revenue and keep mandated climate change and reliability programs on track. SMUD's rates at the end of the year remained about 25 percent lower than neighboring PG&E's.

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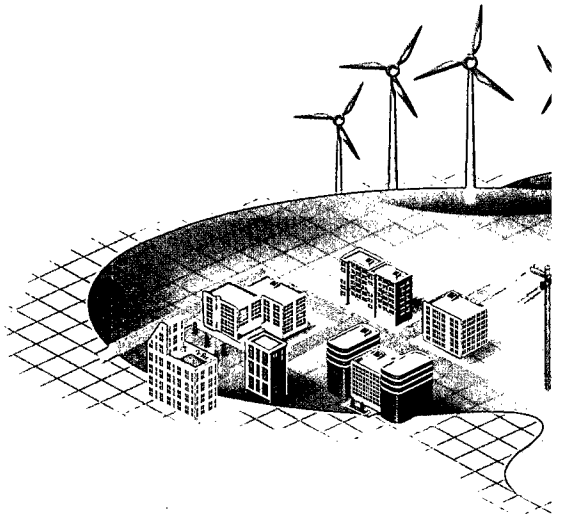
The *SmartSacramento* project will touch on everything from the distribution of electricity to its consumption with an approach that will serve as a model for the nation's electric grid.



SMUD received the largest smart grid

Big vote of confidence

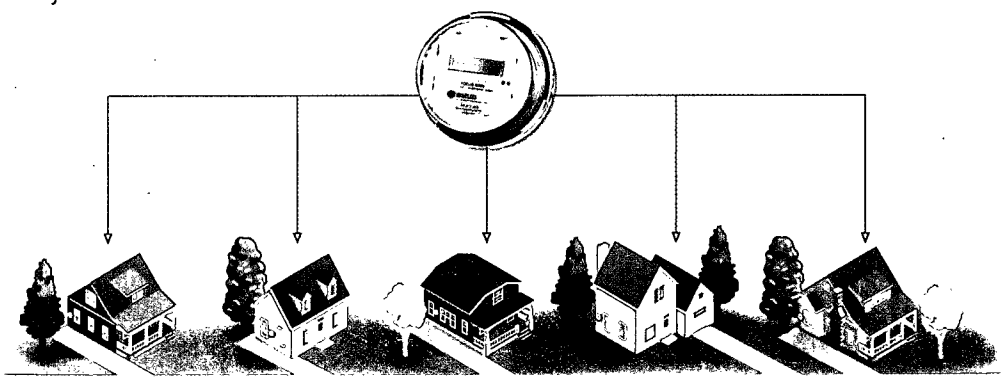
In terms of making a big splash, the year's highlight came when SMUD and three partners were awarded a $127.5 million infrastructure grant in October for the expedited development of a smart grid. SMUD had already begun installing the first of 600,000 "smart" meters, a project that will continue into 2011 and will give customers more knowledge to make their own energy choices. The federal grant supports this effort while helping SMUD transition to a smart grid throughout its entire service territory.

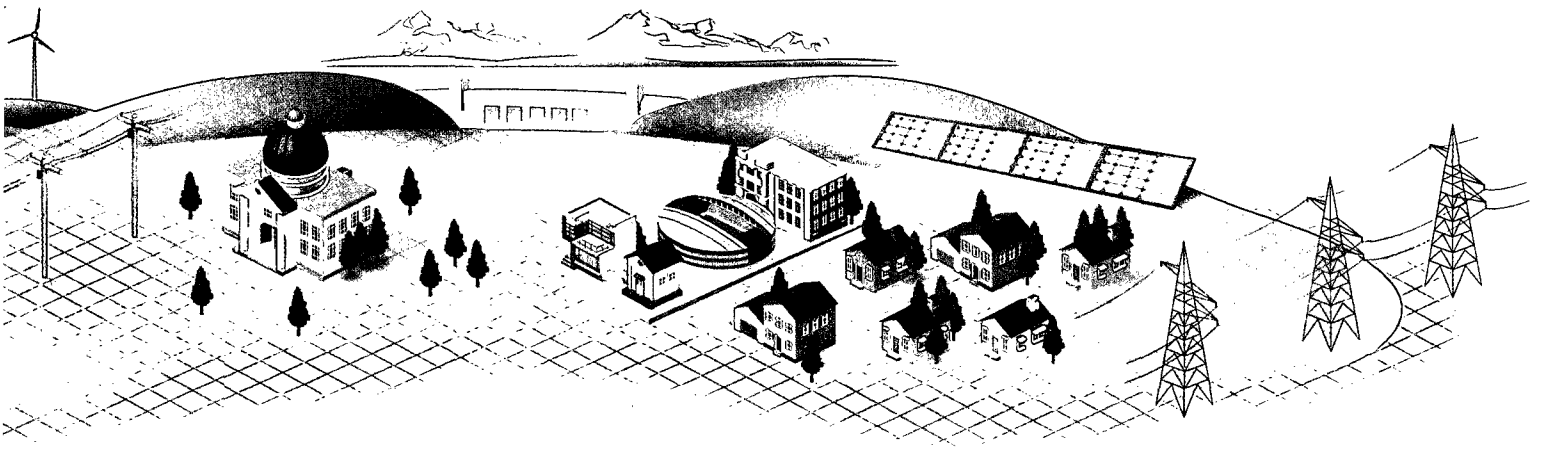
Building a national model

SMUD received by far the largest smart grid grant of any California utility from the U.S. Department of Energy – a clear vote of confidence for its long-term business vision. The SmartSacramento project will touch on everything from the distribution of electricity to its consumption with an approach that will serve as a model for the nation's electric grid.

Advocating for customers

SMUD is participating in a variety of state and federal legislative activities to address climate change. As California moves toward implementing Assembly Bill 32 – the landmark climate change legislation that requests the reduction of state greenhouse gas emissions to 1990 levels by 2020 – SMUD is representing customer interests by advocating local flexibility to achieve climate goals. SMUD will continue to ensure that the costs of achieving the climate goals set forth by the state and the SMUD Board will remain reasonable.





infrastructure grant of any California utility.

$127.5 Million

Reliably reliable

Clean energy isn't practical unless it's delivered reliably. SMUD was recognized nationally for providing safe and reliable electricity to its customers. In 2009, the American Public Power Association awarded SMUD the "Reliable Public Power Provider" platinum award.

Customer satisfaction

Last but not least, SMUD received a vote of confidence from its customers in 2009. In the J.D. Power and Associates survey of residential customers, SMUD received the highest score of any California utility and was second in the western United States, narrowly trailing Salt River Project of Arizona. Customers are SMUD's most valued partners.

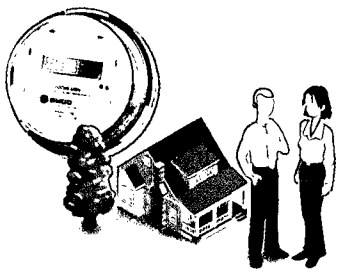
In the J.D. Power and Associates survey of residential customers, SMUD received the highest score of any California utility.

Partnerships for a cleaner tomorrow

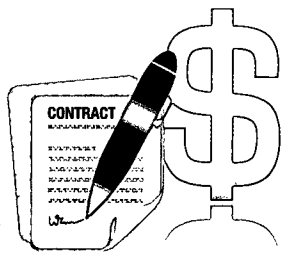
SMUD's vision is to empower its customers with solutions and options that increase energy efficiency, protect the environment, reduce global warming, and lower the cost to serve our region.

To implement its vision, SMUD is constantly developing and fostering partnerships that best serve the community's quality of life and economic vitality.

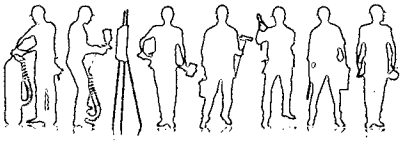
Being a good community partner takes



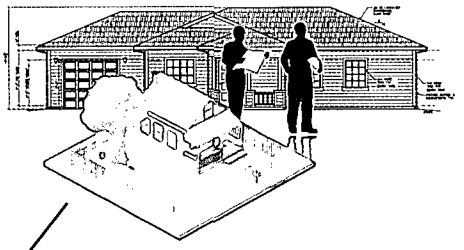
Partnering with customers to make better energy choices. In 2009, SMUD began installing the first of 600,000 smart meters – meters that use digital technology which will eventually help customers have more control over their electric bills. While SMUD had already begun its first smart meters when the U.S. Department of Energy awarded the utility and its three partners a grant of $127.5 million to develop a smart grid, the timing couldn't have been better. The federal funding will accelerate the process and provide earlier benefits to SMUD customers.



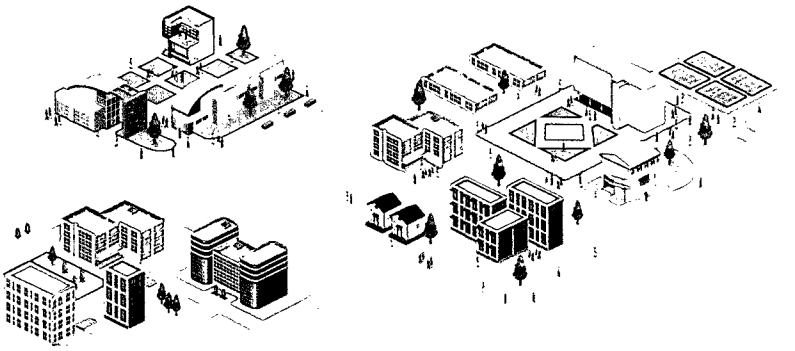
Awarding $132 million in contracts to suppliers in 2009, including $32 million to small businesses. SMUD also provided $3.6 million to business customers in 2009 for energy efficiency rebates and incentives.



Partnering with Sacramento Area Trade & Commerce Organization, local chambers of commerce and other groups to help create and retain jobs.



Partnering with Habitat for Humanity to build an ultra-efficient home for Habitat for Humanity in Del Paso Heights.

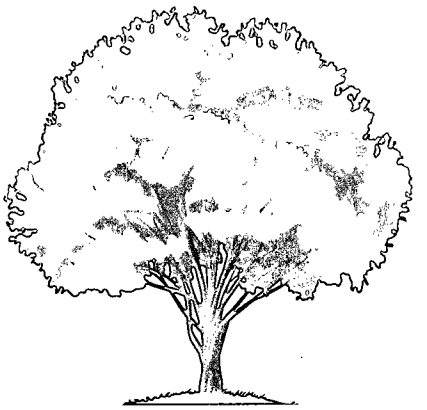


Leading three of the region's largest employers in putting together a federal stimulus proposal that results in a $127.5 million grant to expedite the development of a smart grid.

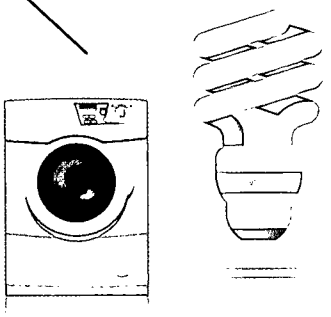
SMUD enlisted the invaluable support of California's Department of General Services, Los Rios Community College District and California State University, Sacramento.

CSUS will implement automated meter network and energy management systems that are capable of communicating through the Internet. Los Rios will design a wireless system of smart grid applications that will be shared with SMUD. The Department of General Services will replace outdated pneumatic controls with direct digital controls integrated with energy management systems. All three partners will be implementing plug-in hybrid/electric vehicle "smart" charging stations.

many forms.



Working with the Sacramento Tree Foundation to plant more than 475,000 free shade trees throughout Sacramento County since 1990.



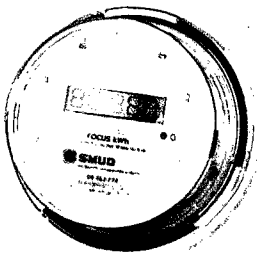
Joining with retailers to encourage the purchase of energy-efficient electronic products.

Whether they involve millions of dollars or a fraction of that, wide-ranging partnerships help SMUD invest in solutions that benefit the entire community.

Smart grid 101

SMUD customers wanted more say when they voted to replace investor-owned PG&E with SMUD, a publicly owned utility. The advent of smart metering will give customers more say than they've ever had in their energy usage.

The electric industry is beginning to make the transformation from a centralized, producer-controlled network to one that is less centralized and more consumer-interactive...one that's smarter.



So what is exactly the "smart grid"?

In short, it's a modernized grid that delivers electricity from suppliers to consumers by incorporating digital technology that gives end-use customers the opportunity to participate directly in how they consume energy.

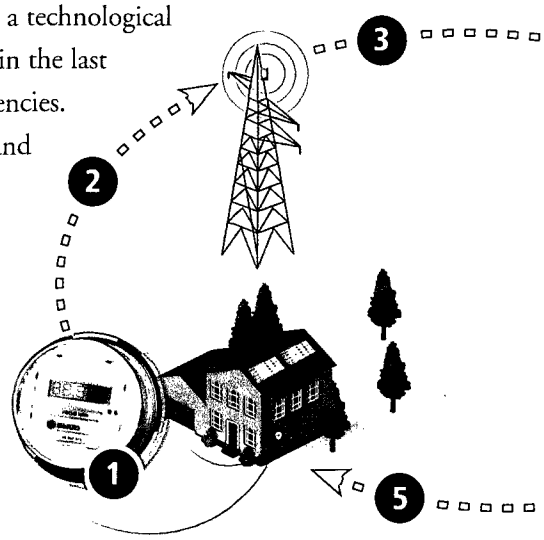
SMUD will give customers more say in

The smart grid future

In the future, smart grid technology, combined with SMUD's continued focus on offering innovative programs, will enable customers to select energy plans that best meet their own personal needs.

In the not-too-distant future, customers with smart meters will be able to log on to a Web site and view detailed records of their electricity use, including the previous day's usage. The smart grid will also improve reliability, reducing the frequency and duration of outages, and will improve air quality by helping SMUD manage peak loads during the hot summer months.

The current electric grid is strained. From a technological standpoint, it really hasn't changed much in the last 100 years. It's showing its age and inefficiencies. Its lack of technology to provide utilities and customers with better information in real time hurts the entire electricity system's security and efficiency and places unnecessary cost burdens on customers.



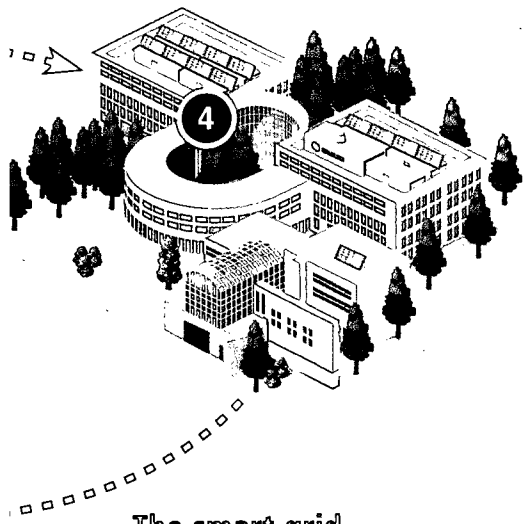
Also, the existing grid was not designed to handle intermittent renewable power sources such as wind or solar. There is a national consensus that we need to reduce our reliance on fossil-burning fuels that contribute to climate change and global warming by making renewable energy resources a mandated part of a utility's portfolio mix.

Smart meters are the foundation for the smart grid. SMUD began installing its first smart meters in late 2009. The project will be completed in 2011.

With the assistance of the federal grant, SMUD has a tremendous opportunity to lead the way toward a cleaner future...not just for Sacramento but for the entire country.

The power is in my hands.

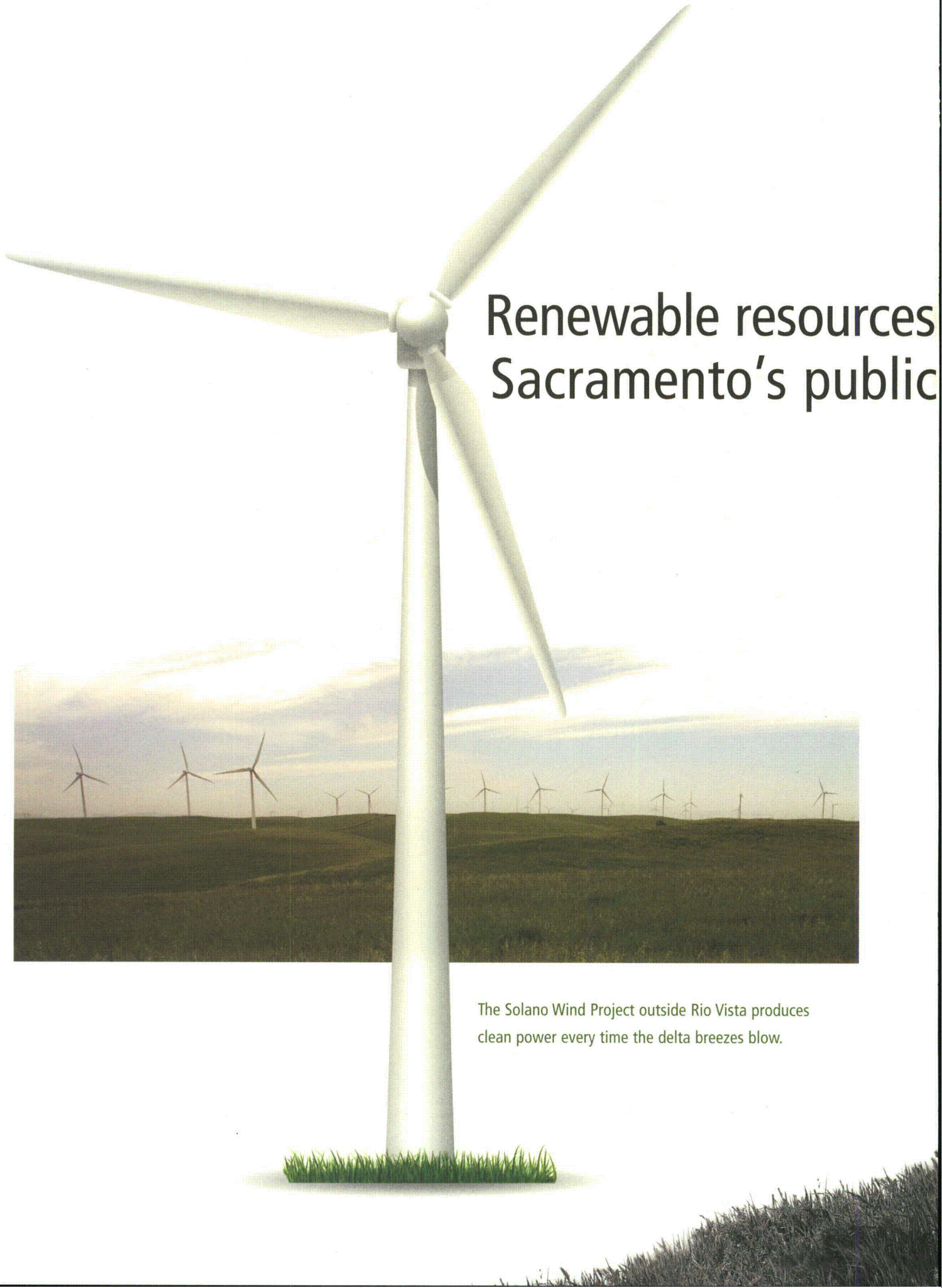
their energy usage.



The smart grid

1) Smart meter collects and automatically stores customer electricity usage data at regularly scheduled intervals.
2) Customer's usage data is then securely transmitted to a local collection point.
3) The collection point then securely transmits the usage data to SMUD.
4) SMUD then uses the electricity usage information to bill the customer and provide energy usage data online.
5) Installing smart meters now will build the foundation for the future smart grid applications that will optimize customer service through two-way communication between SMUD and its customers.

Renewable resources
Sacramento's public



The Solano Wind Project outside Rio Vista produces clean power every time the delta breezes blow.

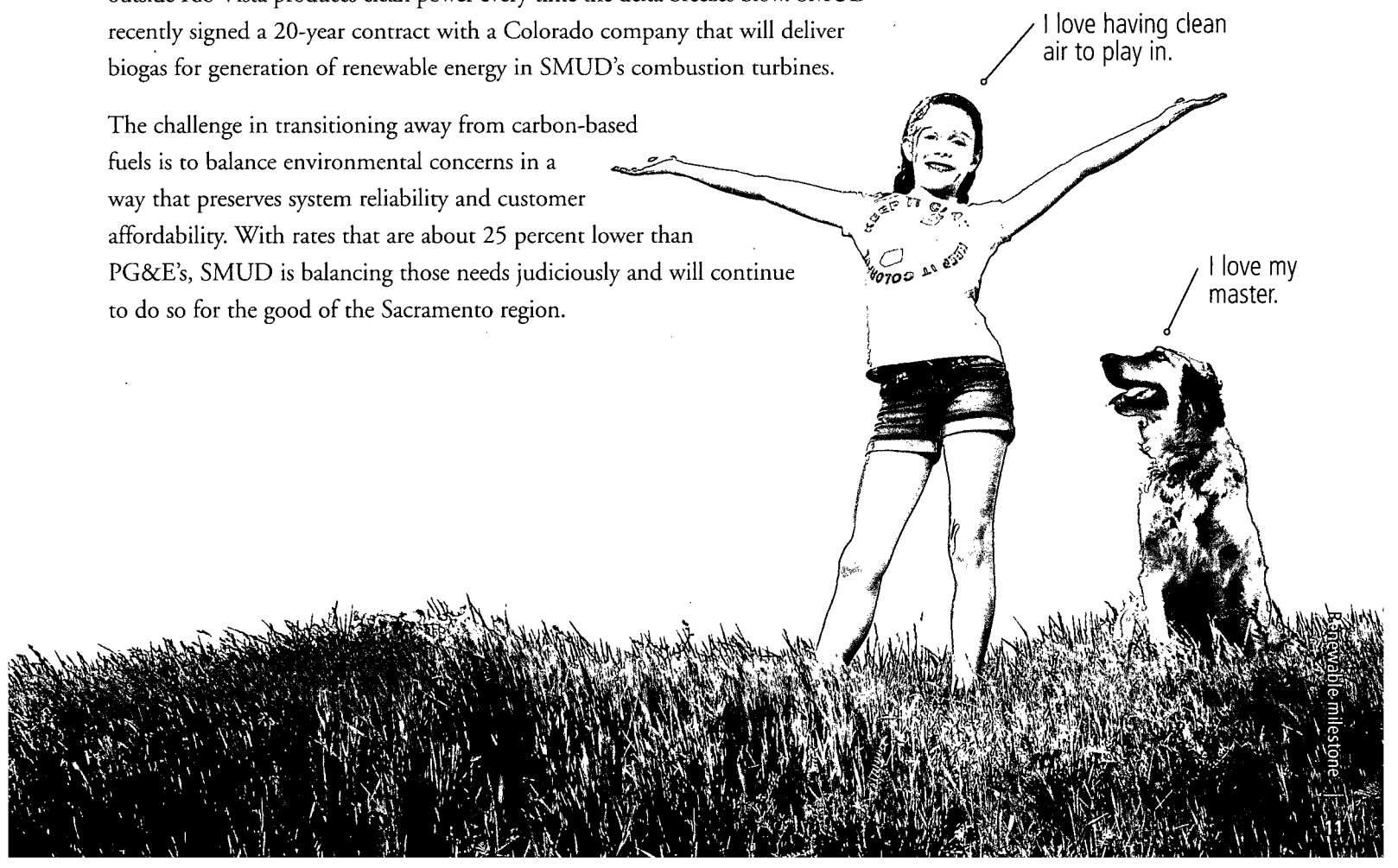
In 2010, SMUD will become the first large California electric utility to cross a significant "green" threshold – obtaining 20 percent of its energy from renewable resources.

reduce SMUD's carbon footprint and help utility move toward a more sustainable future.

Whether they come from the sun, wind or wood chips, renewable resources reduce SMUD's carbon footprint and help Sacramento's public utility move toward a more sustainable future. The less carbon that's released in the generation of electricity, the less greenhouse gases are emitted into the air.

SMUD's success in reaching the 20-percent mark in 2010 was years in the making. The 1-megawatt photovoltaic plant at Rancho Seco was one of the world's largest solar facilities when it opened in 1984. The Solano Wind Project outside Rio Vista produces clean power every time the delta breezes blow. SMUD recently signed a 20-year contract with a Colorado company that will deliver biogas for generation of renewable energy in SMUD's combustion turbines.

The challenge in transitioning away from carbon-based fuels is to balance environmental concerns in a way that preserves system reliability and customer affordability. With rates that are about 25 percent lower than PG&E's, SMUD is balancing those needs judiciously and will continue to do so for the good of the Sacramento region.



East Campus – Operations Center

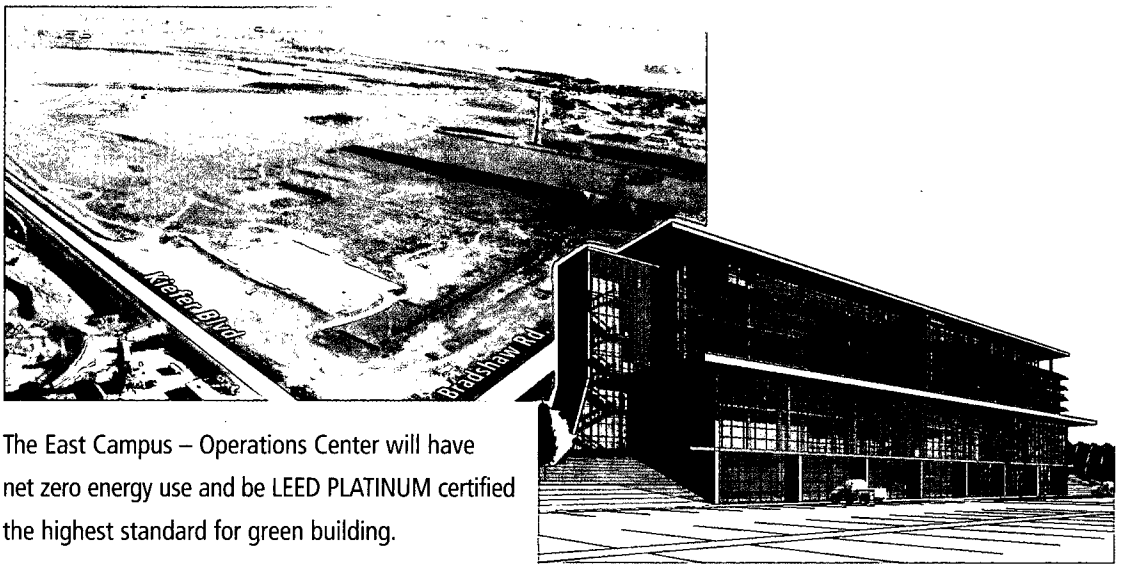
SMUD acquired its corporate yard from PG&E in 1946 after Sacramento County residents voted to form their own public utility. While the 19-acre facility on 59th Street served SMUD well for several decades, the move to a bigger site is long overdue.

While the 19-acre facility on 59th Street the move to a bigger site is long overdue.

SMUD had 65,000 customers in 1946. Today, the number is approaching 600,000. To relieve SMUD's growing pains, the Board of Directors voted in 2009 to relocate SMUD's corporate yard to a new 51-acre site six and a half miles down the road at the southeast corner of Bradshaw Road and Kiefer Boulevard.

Construction is scheduled to begin in 2011 and be completed in 2013. About 750 SMUD employees will move along with the trucks, poles, transformers and equipment that keep the power flowing 24/7.

The project will also provide a boost to the local economy, generating about 300 temporary construction jobs and $19 million in contracts with local businesses. The local real estate market made the timing of the purchase favorable to SMUD and its customer-owners.



The East Campus – Operations Center will have net zero energy use and be LEED PLATINUM certified the highest standard for green building.

served SMUD well for several decades,

The old corporate yard could get pretty crowded at times.

Steve Hintze, Line Foreman

It'll be nice to have more elbow room.

Wes Simmons, Apprentice Lineman

Chevy Volt EV partnership

SMUD will be one of the first utility partners to test drive Chevrolet's much-anticipated Volt, an extended range, plug-in hybrid electric vehicle (PHEV).

The U.S. Department of Energy is putting major emphasis on PHEVs to help auto-makers meet increased fuel economy standards while reducing greenhouse gas emissions. President Obama set a goal of having 1 million PHEVs on the road by 2015.

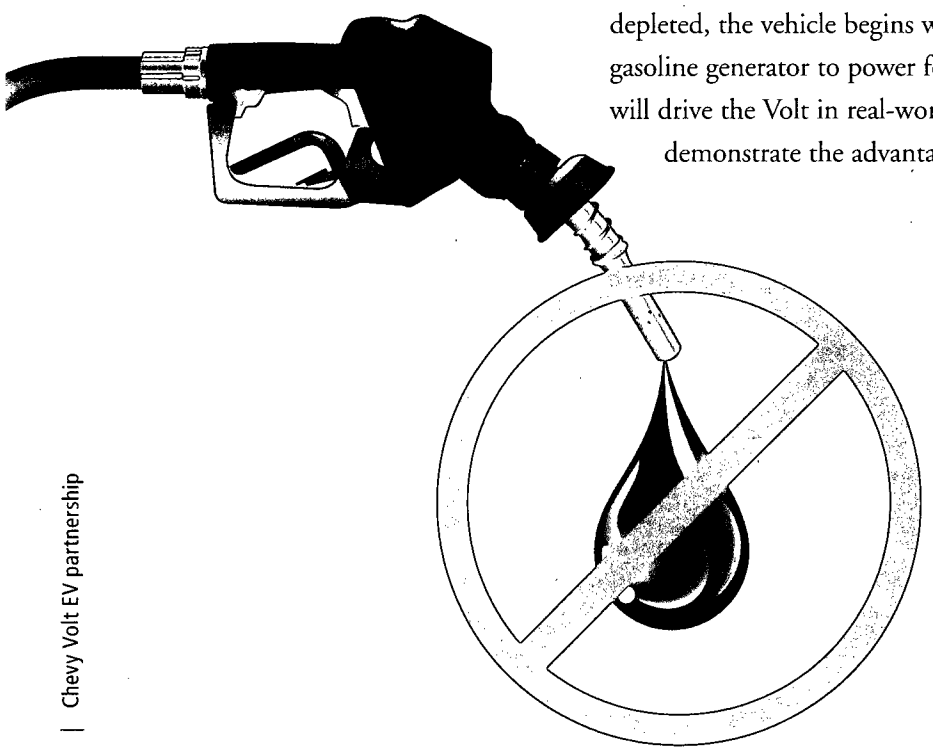
SMUD will get five or six Volts from General Motors for testing and evaluation. The program is part of the Transportation Electrification Initiative under the American Recovery and Reinvestment Act grant administered by the U.S. Department of Energy.

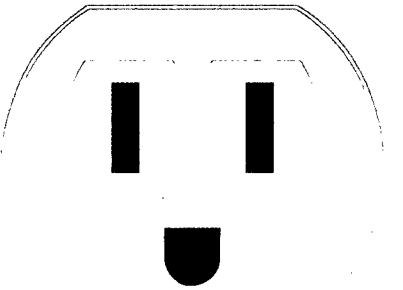
SMUD will test Chevy Volts under a federal consumption by promoting electric transp

SMUD was awarded $2.5 million in grants from DOE and the California Energy Commission for the electric transportation project. SMUD and its partners, the State Department of General Services and the City of Sacramento, will test 29 Volts as part of the project.

The cars, which are the world's first mass-produced PHEVs, should start arriving at SMUD in January 2011.

The Volt provides electric-only driving for up to 40 miles. Once the battery is depleted, the vehicle begins working in extended-range mode using the onboard gasoline generator to power for the vehicle for an additional 300 miles. SMUD will drive the Volt in real-world conditions to monitor its performance and demonstrate the advantages of PHEVs to the public.

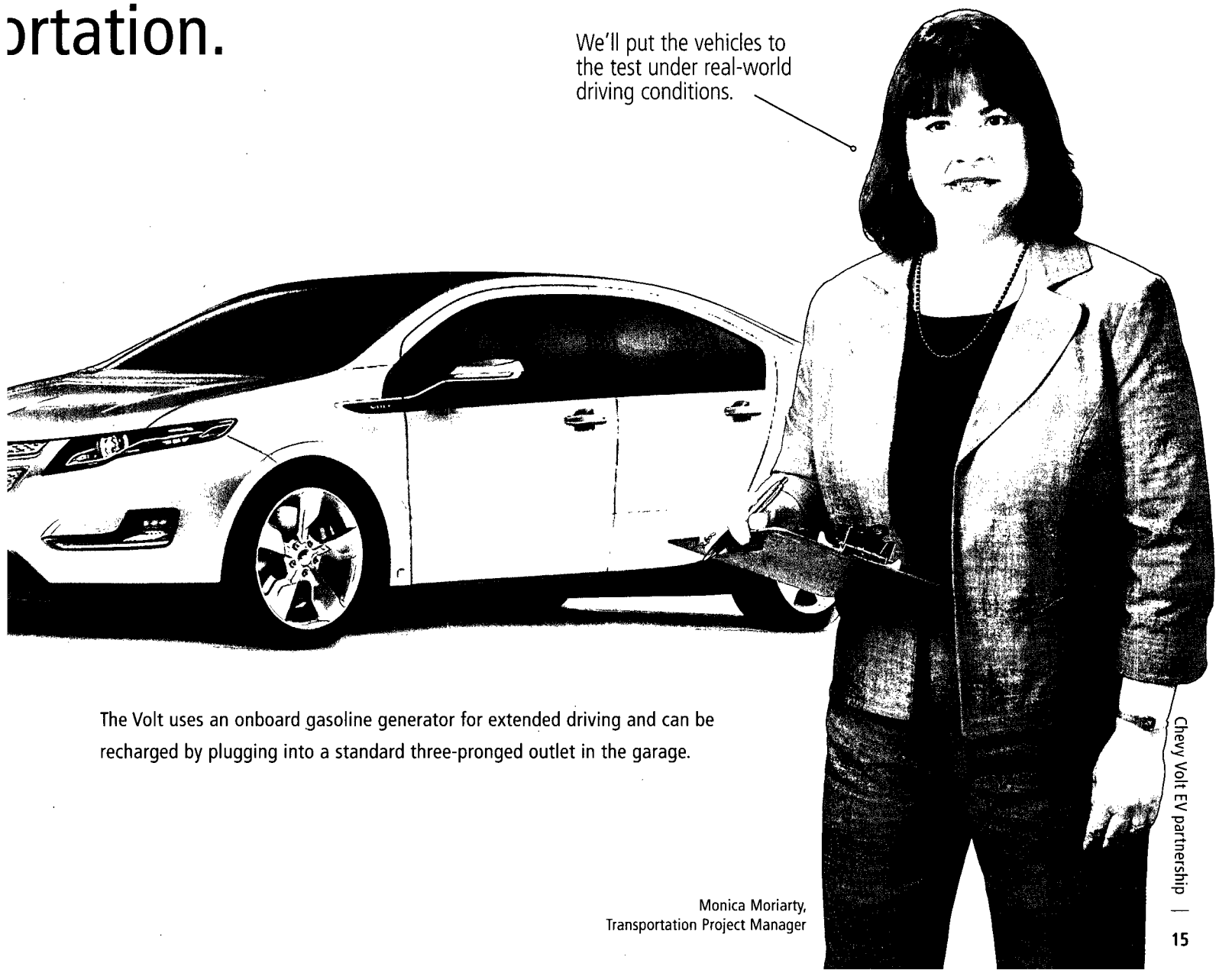




Plug-it-in like any other home appliance.

stimulus grant to reduce petroleum
ɔrtation.

We'll put the vehicles to the test under real-world driving conditions.

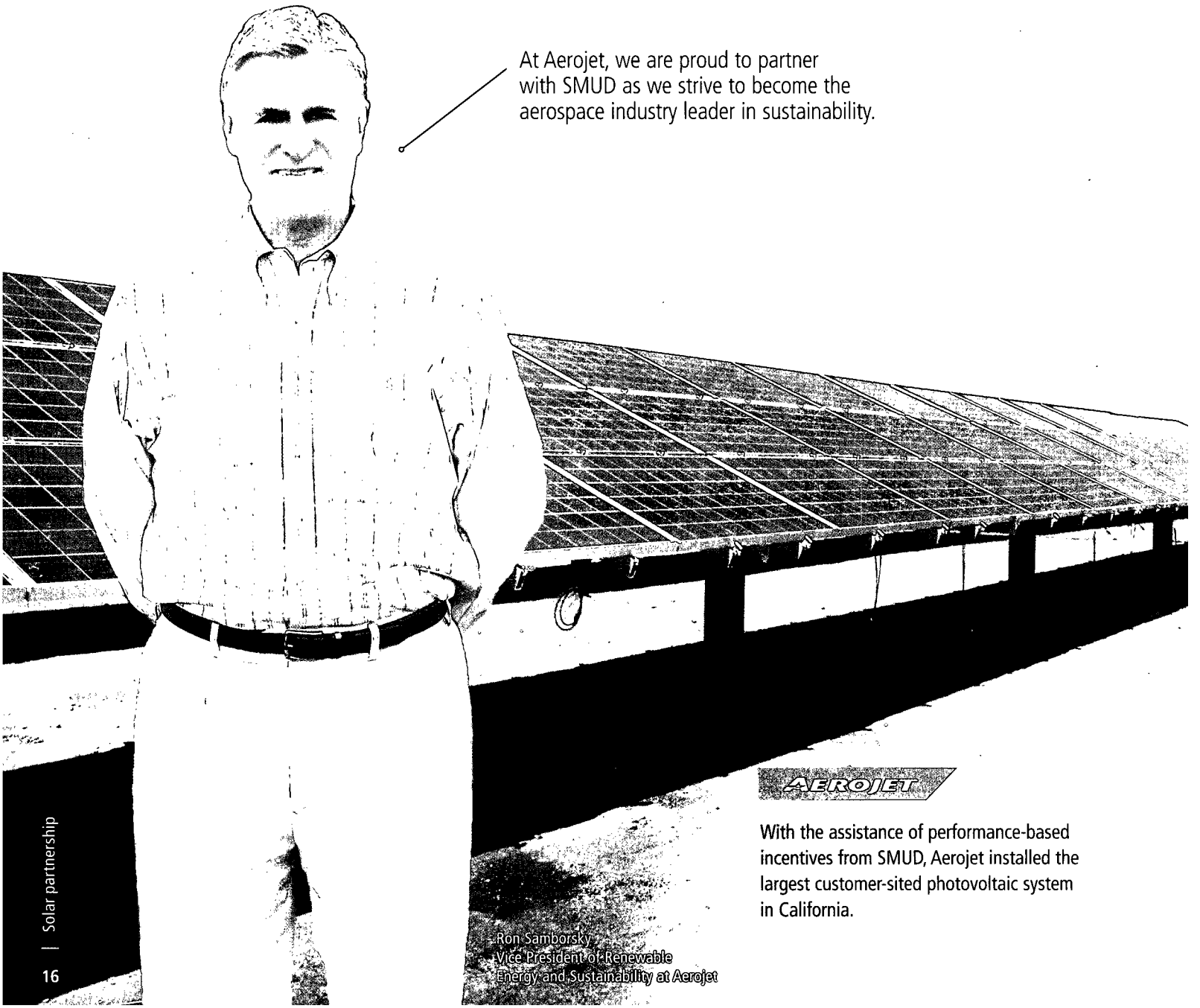


The Volt uses an onboard gasoline generator for extended driving and can be recharged by plugging into a standard three-pronged outlet in the garage.

Monica Moriarty,
Transportation Project Manager

The business community partnership that benefits

At Aerojet, we are proud to partner with SMUD as we strive to become the aerospace industry leader in sustainability.



Ron Samborsky
Vice President of Renewable Energy and Sustainability at Aerojet

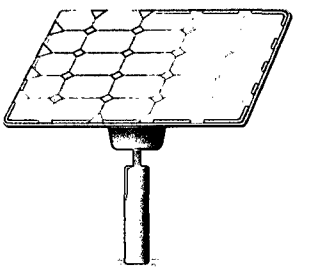
AEROJET

With the assistance of performance-based incentives from SMUD, Aerojet installed the largest customer-sited photovoltaic system in California.

Solar partnership

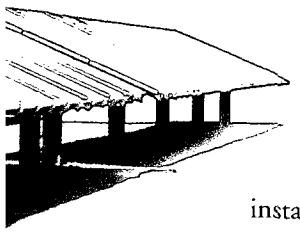
supports SMUD's values and goals, a the region's economic vitality and air quality.

In a landmark partnership with a large business customer, SMUD provided performance-based incentive payments for a 3.6-megawatt solar project at Aerojet. The incentives helped defray the cost of what will be the largest customer-sited photovoltaic system in California.



Since they account for 60 percent of SMUD's sales revenue, business customers are invaluable partners in helping the public utility meet its clean-energy goals. Promoting local and regional economic benefits is not only in SMUD's best interest, it's in the best interest of all customers.

At Aerojet, the photovoltaic panels will cover more than 20 acres and will generate an estimated 6.5 gigawatt hours of electricity a year. Aerojet expects the photovoltaic system to provide more than 20 percent of the power required for the aerospace and defense company's groundwater remediation program.



The SMUD Board also authorized payments for a second 1-megawatt solar expansion at Siemens in south Sacramento. Aerojet is also expanding its system with an additional 2.4 megawatts, and Costco and Kohl's are each installing approximately 1.5 megawatts of solar at their retail stores in Sacramento. The projects will help SMUD meet aggressive state-mandated goals for expanding solar power to reduce greenhouse gas emissions.

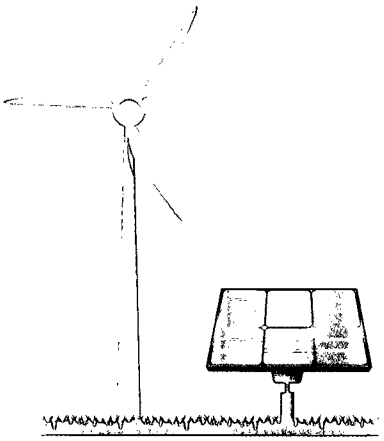
The business community supports SMUD's values and goals, a partnership that benefits the region's economic vitality and air quality. In early 2010, SMUD received the second-highest commercial customer satisfaction score in a J.D. Power and Associates nationwide survey of electric utilities.

The next generation of power

SMUD's day-to-day operations focus largely on providing affordable, reliable power. But just as California is on the cutting edge of clean technology, SMUD is seen as one of the nation's leaders in the development of new energy solutions.

SMUD's Advanced Renewable and Distributed Generation Technology (ARDGT) group is responsible for the research, development and commercialization of new energy supply technologies that will assist SMUD in meeting its reliability, rate stability, environmental and technology leadership goals.

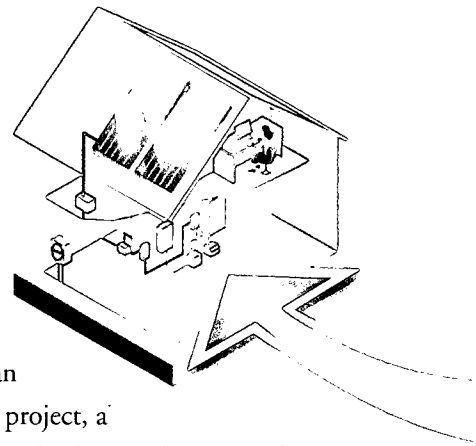
SMUD is seen as one of the state's leaders



By its very nature, research and development doesn't reap major benefits immediately. But SMUD's R&D efforts provide community value and position its customers for possible benefits as the new technologies mature.

When SMUD began its R&D work in photovoltaic applications in the 1980s, the cost of solar power was several times higher than it is now. Similarly, early wind electricity turbines were small, ranging in size from 25 to 100 kilowatts. Those smaller turbines produced electricity that cost several times the cost of the current wind turbines, now 1 to 3 megawatts in size. SMUD was on the cutting edge of demonstrating these clean-energy technologies and helping them enter the commercial marketplace.

One of the ARDGT group's most exciting projects involves the development of two energy storage sites. Energy storage is a potential game-changer in the electric utility industry. As SMUD and other utilities increase their use of intermittent generation sources such as wind and solar power, energy storage could revolutionize the manner in which those renewable supplies are incorporated into the electric grid.



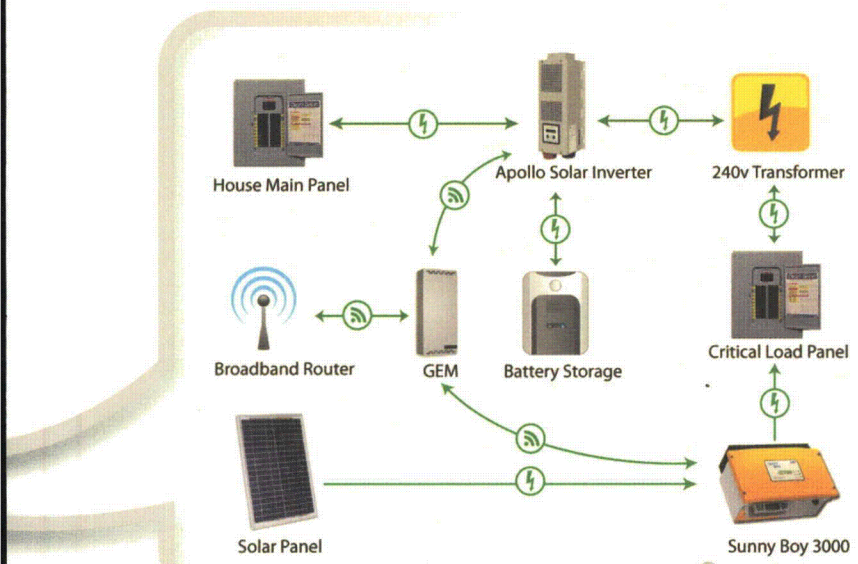
SMUD will host several energy storage sites as part of a federal demonstration grant awarded in 2009 through the American Recovery and Reinvestment Act. In the first project, a flow battery storage system at the headquarters building will test the feasibility of using electricity that is generated earlier in the day into campus operations during the peak hours of 4 p.m. to 8 p.m. while also ensuring that the SMUD campus has uninterrupted power should there be a utility outage.

Another storage demonstration in a Rancho Cordova residential development will determine, among other things, whether smart meters can be used to monitor and control lithium ion battery and photovoltaic systems simultaneously.

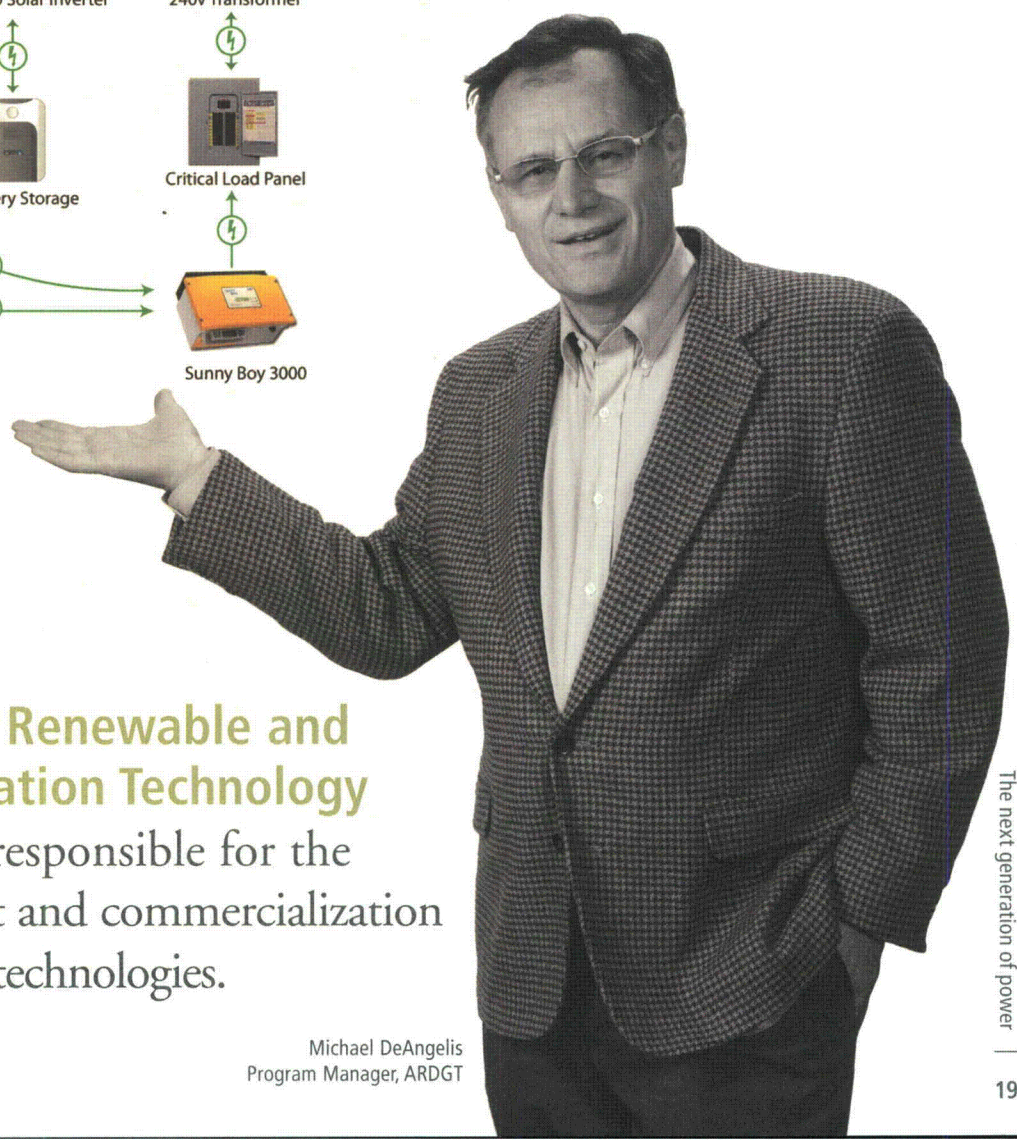
Expected benefits include improved power quality, better use of renewable resources during peak load periods, and energy arbitrage – the ability to charge lithium ion batteries with inexpensive off-peak electricity.

in the development of new energy solutions.

Consider this...We now have new and developing technology to store energy so it can be used later, during peak load periods. Exciting stuff, really!



Courtesy of Gridpoint



SMUD's Advanced Renewable and Distributed Generation Technology (ARDGT) Group is responsible for the research, development and commercialization of new energy supply technologies.

Michael DeAngelis
Program Manager, ARDGT

2009 FINANCIAL STATEMENTS

5 YEAR SUMMARY (Unaudited)

Operating Statistics (i)	2009	2008	2007	2006	2005
Customers at year-end	595,076	592,490	589,599	585,221	577,946
KWH Sales (thousands)					
Sales to customers –					
Residential	4,707,104	4,696,912	4,608,170	4,760,391	4,534,276
Commercial, industrial & other	5,984,803	6,219,838	6,209,689	6,038,839	5,951,447
Subtotal	10,691,907	10,916,750	10,817,859	10,799,230	10,485,723
Sales of surplus power	2,133,049	2,460,487	2,427,964	3,964,326	1,496,569
Total	12,824,956	13,377,237	13,245,823	14,763,556	11,982,292
Revenues (thousands of dollars)					
Sales to Customers –					
Residential	$ 514,320	$ 540,546	$ 493,910	$ 515,025	$ 480,100
Commercial, industrial & other	631,251	627,571	589,922	566,851	557,305
Subtotal	1,145,571	1,168,117	1,083,832	1,081,876	1,037,405
Sales of surplus power	58,626	170,640	134,002	191,931	73,475
Sales of surplus gas	61,331	139,275	78,292	112,719	114,313
Total (ii)	$ 1,265,528	$ 1,478,032	$ 1,296,126	$ 1,386,526	$ 1,225,193
Average kWh sales per residential customer	8,955	8,982	8,841	9,202	8,909
Average revenue per residential kWh sold (cents)	11.07	11.11	10.49	10.60	10.41
Power supply (thousands of kWh)					
Hydroelectric	1,442,015	886,728	1,056,893	2,804,704	2,236,818
Cogeneration	5,166,669	5,995,248	5,886,579	4,775,933	2,196,055
Windpower	173,775	261,338	117,197	73,887	36,828
Photovoltaic	2,236	2,655	2,235	2,323	2,341
Gas turbine	–	–	181	7,918	2,225
Purchases	6,534,376	6,756,059	6,724,160	7,679,518	7,968,762
Net system peak demand - 1 hour (kW)	2,848,001	3,086,000	3,099,000	3,280,000	2,959,000
Equivalent Full Time Employees at year-end	2,113	2,197	2,226	2,213	2,279
Financial Statistics (thousands of dollars)					
Operating revenues	$ 1,293,337	$ 1,486,679	$ 1,312,083	$ 1,354,427	$ 1,225,193
Operating expenses –					
Purchased and interchanged power	339,310	446,302	385,021	388,714	463,710
Operation and maintenance	718,890	752,554	666,661	620,002	461,229
Depreciation and amortization	150,811	145,196	133,603	125,937	107,751
Decommissioning	421	4,700	31,620	30,894	29,408
Total operating expenses	1,209,432	1,348,752	1,216,905	1,165,547	1,062,098
Operating income	83,905	137,927	95,178	188,880	163,095
Other income	28,051	38,365	47,340	47,421	26,591
Income before interest charges	111,956	176,292	142,518	236,301	189,686
Interest charges	123,741	164,322	147,101	128,895	106,414
Net increase (decrease) in net assets before extraordinary income	$ (11,785)	$ 11,970	$ (4,583)	$ 107,406	$ 83,272
Extraordinary Income	$ 17,170	$ 10,168	$ –	$ –	$ –
Net increase (decrease) in net assets	$ 5,385	$ 22,138	$ (4,583)	$ 107,406	$ 83,272
Funds available for revenue bond debt service	$ 256,453	$ 264,100	$ 245,604	$ 345,293	$ 310,257
Revenue bond debt service	$ 178,837	$ 174,846	$ 181,706	$ 174,121	$ 160,036
Revenue bond debt service coverage ratio	1.43	1.51	1.35	1.98	1.94
Electric utility plant – net	$ 2,978,623	$ 2,926,746	$ 2,882,321	$ 2,734,776	$ 2,662,311
Capitalization					
Long-term debt	$ 3,010,567	$ 3,205,101	$ 3,173,216	$ 2,518,309	$ 2,303,188
Customer's equity	$ 515,934	$ 510,549	$ 488,411	$ 492,994	$ 385,588

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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BAKER TILLY

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, 2009 and 2008, 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, 2009 and 2008, 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, effective January 1, 2008 the Sacramento Municipal Utility District adopted the provisions of FASB Statement No. 157 – *Fair Value Measurements*, now included under FASB ASC 820, 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 asset retirement obligations that are measured at fair value on a nonrecurring basis under FASB ASC 820 is January 1, 2009.

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.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
February 19, 2010

The following discussion and analysis of the Sacramento Municipal Utility District and its component units (SMUD) financial performance provides an overview of SMUD's financial activities for the years ended December 31, 2009 and 2008. This discussion and analysis should be read in conjunction with SMUD's financial statements and accompanying notes, which follow this section.

BACKGROUND

SMUD 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. SMUD 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. SMUD 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 SMUD services. Changes in such rates require formal action, after public hearing, by the Board.

In June 2009, the Board approved an average system rate increase of approximately 5.5 percent that was effective in rates beginning September 1, 2009; 5.5 percent effective in rates beginning March 1, 2010; and 2.25 percent effective in rates January 1, 2011. In April 2009, $11 million from the Hydro Rate Stabilization Fund was recognized as revenue to cover the budget impact of lower hydro generation resulting from lower precipitation for the period April 1, 2008 through March 31, 2009.

Financial Reporting

SMUD's accounting records are maintained in accordance with Generally Accepted Accounting Principles (GAAP) 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). Over the years, the FASB and other designated GAAP-setting bodies, have issued standards in the form of FASB Statements, Interpretations, etc. The FASB recognized the complexity of its standard-setting process and embarked on a revised process in 2004 that culminated in the release on July 1, 2009, of the FASB Accounting Standards Codification™, sometimes referred to the Codification or ASC. The Codification does not change how the company accounts for its transactions or the nature of related disclosures made. However, when referring to guidance issued by the FASB, SMUD refers to topics in the ASC rather than Statement 143, etc. The above change was made effective by the FASB for periods ending on or after September 15, 2009. References to GAAP in this Annual Report have been updated to reflect the guidance in the Codification. SMUD'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 Financial Accounting Standards Board ASC 980, formerly known as 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, 2009, SMUD had total Regulatory Costs for Future Recovery of $364 million, which is a net decrease of $2 million from 2008. The decrease is primarily due to a reduction in the deferred costs for Rancho Seco decommissioning and a decrease in the valuation of derivative financial instruments, partially offset by a deferred pollution remediation obligation for one of SMUD's transmission substations. SMUD also had Regulatory Credits of $285 million as of December 31, 2009, which is a net decrease of $34 million from 2008. The decrease is primarily due to the recognition of revenue for the natural gas settlement that was deferred in 2008, the recognition of $11 million of revenue from the Hydro Rate Stabilization Fund to offset lower hydro generation as a result of lower precipitation, and the recognition of revenues from the Rate Stabilization Fund to offset lower Western Area Power Administration (Western) energy deliveries. These reductions of Regulatory Credits were partially offset by the increase of deferred revenues related to Contributions In Aid of Construction. 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 SMUD 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 SMUD's financial status. The Consolidated Balance Sheets include all of SMUD'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 SMUD'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	December 31, 2009	2008	2007
		(millions of dollars)	
Assets			
Electric Utility Plant – net	$ 2,979	$ 2,927	$ 2,882
Restricted and Designated Assets	202	274	273
Current Assets	786	739	734
Noncurrent Assets and Deferred Charges	860	1,159	1,077
	$ 4,827	$ 5,099	$ 4,966
Liabilities and Net Assets			
Long-Term Debt – net	$ 3,010	$ 3,205	$ 3,173
Current Liabilities and Deferred Credits	690	740	724
Noncurrent Liabilities and Deferred Credits	611	643	580
Net Assets:			
Invested in capital, net of related debt	219	274	321
Restricted	87	122	95
Unrestricted	210	115	73
	$ 4,827	$ 5,099	$ 4,966

ASSETS

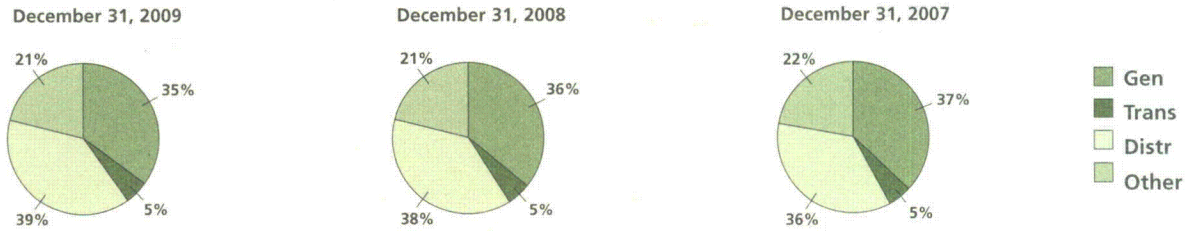
Utility Plant – net

2009 Compared to 2008 SMUD has invested approximately $3.0 billion in utility plant assets and construction work in progress net of accumulated depreciation at December 31, 2009. Net utility plant makes up about 62 percent of SMUD's assets, approximately 5 percent more than the previous year. During 2009, SMUD capitalized approximately $217 million of additions to utility plant, including additions to construction work in progress in SMUD's consolidated financial statements. This was a result of routine capital additions for generation, transmission, distribution, and general plant.

2008 Compared to 2007 SMUD 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 SMUD's assets, approximately 1 percent less than the previous year. During 2008, SMUD capitalized approximately $200 million of additions to utility plant, including additions to construction work in progress in SMUD's consolidated financial statements. This was a result of routine capital additions for generation, transmission, distribution, and general plant.

SMUD 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 SMUD, the contract was terminated in February 2005. SMUD is currently in litigation with Fru-Con to resolve these disputes. SMUD 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

2009 Compared to 2008 SMUD's Restricted and Designated Assets decreased by $72 million during 2009. There was a significant decrease in Revenue Bond, Debt Service, and Construction Reserves mainly due to component unit refundings that resulted in a reduction in the requirement for various restricted funds. The Rate Stabilization Funds decreased due to the recognition of revenue to offset the budget impact of lower hydro generation resulting from lower precipitation in the previous water year and for lower energy deliveries from Western. There also was a significant decrease in funds held for Securities Lending Collateral.

2008 Compared to 2007 SMUD'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 SMUD. 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.

Current Assets

2009 Compared to 2008 Current Assets increased by $47 million in 2009 due to increases in Unrestricted Cash and Cash Equivalents, Receivables for retail customers, Derivative Financial Instruments maturing within one year, and Prepayments. These increases were partially offset by a lower current portion of Restricted and Designated Assets, lower wholesale receivables, and lower Materials and Supplies.

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 Energy Efficiency Loans, and a lower current portion of Derivative Financial Instruments.

Noncurrent Assets and Deferred Charges

2009 Compared to 2008 Total Noncurrent Assets and Deferred Charges decreased by $299 million mainly due to a $272 million reduction in the long-term portion of the Prepaid Gas asset. Twice during 2009, Morgan Stanley Capital Group (MSCG) extinguished component unit debt and made cash payments in exchange for a reduction in their obligation for daily natural gas deliveries. Additionally, there were decreases in the long-term portion of Advance Capacity Payments, Derivative Financial Instruments, Unamortized Debt Issuance Costs, and Preliminary Project Studies and Other.

2008 Compared to 2007 Total Noncurrent Assets and Deferred Charges increased by $82 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 Energy Efficiency Loans and Preliminary Projects and Other. These increases were partially offset by a reduction in the value of Derivative Financial Instruments.

LIABILITIES

Long-Term Debt

2009 Compared to 2008 In January 2009, SMUD extinguished $250 million of 2007 Northern California Gas Authority #1 (NCGA) Series B Gas Project Revenue Bonds, a component unit of SMUD. In August 2009, SMUD extinguished an additional $10 million of 2007 NCGA Series B Gas Project Revenue Bonds. For both extinguishments, MSCG funded the bond extinguishment plus made cash payments to NCGA in exchange for a lowering their obligation for daily natural gas deliveries.

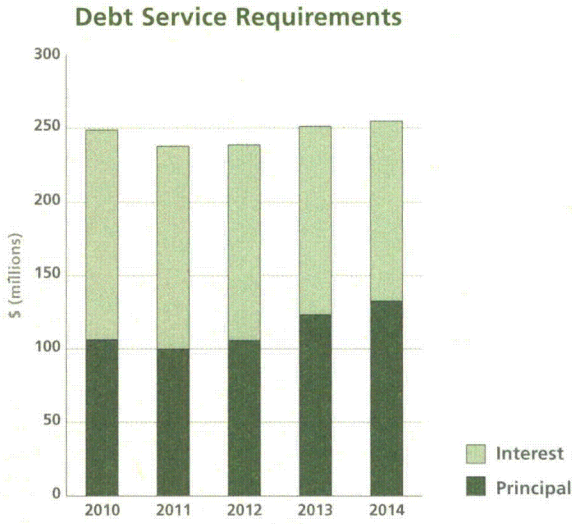
In May 2009, SMUD issued $200 million of fixed-rate 2009 Series V Electric Revenue Bonds. These bonds qualify under the federal program as "Build America Bonds" and SMUD expects to receive a cash subsidy from the United States Treasury equal to 35 percent of the interest payable. The interest payments on these bonds are fully taxable.

In August 2009, SMUD issued $58 million of fixed-rate 2009 Series Sacramento Cogeneration Authority (SCA) Cogeneration Project Revenue Refunding Bonds, a component unit of SMUD. Bond proceeds plus $7 million of available funds were used to refund $68 million of outstanding 1998 Series SCA Cogeneration Project Revenue Bonds.

In August 2009, SMUD issued $49 million of fixed-rate 2009 Series Central Valley Financing Authority (CVFA) Cogeneration Project Revenue Refunding Bonds, a component unit of SMUD. Bond proceeds plus $5 million of available funds were used to refund $55 million of outstanding 1998 Series CVFA Cogeneration Project Revenue Bonds.

2008 Compared to 2007 In June 2008, SMUD 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, SMUD issued $198 million of variable-rate Series J and Series K Subordinated Electric Revenue Refunding Bonds to refund various Auction Rate Securities.

The following table shows SMUD's future debt service requirements through 2014 as of December 31, 2009:



As of December 31, 2009, SMUD had an underlying rating of "A+" from Standard & Poor's, "A" from Fitch, and "A1" from Moody's. Most of SMUD's bonds are insured and are rated by the rating agencies at the higher of the insurer's rating or SMUD's underlying rating.

Current Liabilities and Deferred Credits

2009 Compared to 2008 Current Liabilities and Deferred Credits decreased by approximately $50 million during 2009. The most significant decrease was a reduction in SMUD's obligation for Securities Lending Collateral reflecting lower securities lending activity in 2009. SMUD's obligation for Credit Support Collateral also decreased during the year as a result of lower energy and gas prices. Other decreases were attributable to Account Payable, Interest Payable, and Regulatory Credits to be recognized within one year. These decreases were partially offset by an increase in Long-Term Debt due within one year and Derivative Financial Instruments maturing within one year.

2008 Compared to 2007 Current Liabilities and Deferred Credits increased by approximately $16 million during 2008. During 2008, SMUD 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.

Noncurrent Liabilities and Deferred Credits

2009 Compared to 2008 Noncurrent Liabilities and Deferred Credits decreased by $32 million during 2009. Accrued Decommissioning decreased by $12 million reflecting a lower estimate for the cost of completing decommissioning at the Rancho Seco nuclear plant site. Also, the value of the liability for Derivative Financial Instruments decreased by approximately $21 million due to price changes in the power and gas markets. Regulatory Credits also decreased by $17 million reflecting the recognition in 2009 of previously deferred revenue. These decreases were partially offset by increase for amounts Due to Affiliated Entity and for Self-Insurance, Deferred Credits and Other.

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.

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

	December 31,		
	2009	2008	2007
		(millions of dollars)	
Operating revenues	$ 1,293	$ 1,487	$ 1,312
Operating expenses	(1,209)	(1,349)	(1,217)
Operating income	84	138	95
Other revenues	28	38	47
Interest charges	(124)	(164)	(147)
Net increase/(decrease) in net assets before extraordinary income	(12)	12	(5)
Extraordinary income	17	10	-0-
Increase/(decrease) in net assets	5	22	(5)
Net assets – beginning of year	511	488	493
Net assets – end of year	$ 516	$ 510	$ 488

CHANGES IN NET ASSETS

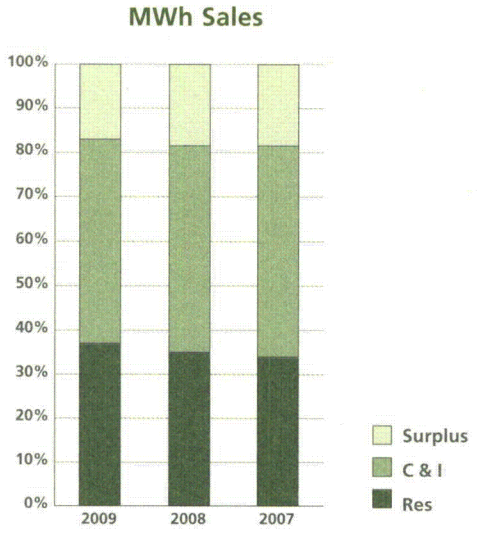
Operating Revenues

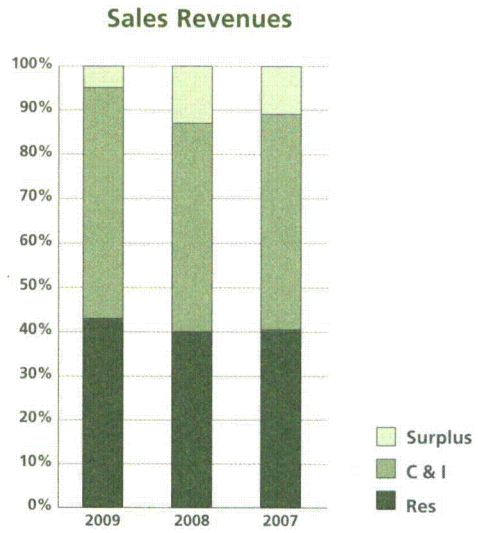
2009 Compared to 2008 Operating Revenues were $1.3 billion in 2009, a decrease of $193 million from 2008. Sales to retail customers were $1.1 billion in 2009, a decrease of $17 million as compared to 2008 sales. SMUD sold about 2.1 percent less energy to its retail customers, which grew from 592,490 customers in 2008 to 595,076 customers at the end of 2009, at an average revenue per kilowatt hour that increased by 0.3 percent. SMUD transferred $16 million from the Rate Stabilization Fund in 2009 as compared to a transfer from the Rate Stabilization Fund of $16 million in 2008. SMUD also transferred $11 million from the Hydro Rate Stabilization Fund during 2009. Additionally, SMUD deferred approximately $1 million of Senate Bill 1 revenues to match them against expenditures in future periods.

Wholesale revenues are comprised of both surplus energy and gas sales. In 2009, surplus gas sales were $61 million as compared to $139 million in 2008. The amount of surplus gas sold was lower, but at higher average prices. Surplus energy sales in 2009 were $112 million lower than in 2008. The decrease is due to lower volume (12 percent) at significantly lower average prices (61 percent) than in 2008.

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. SMUD 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. SMUD transferred $16 million from the Rate Stabilization Fund as compared to a transfer from the Rate Stabilization Fund of $16 million in 2007. SMUD also deferred approximately $8 million of Senate Bill 1 revenues to match them against the expenditures in future periods.

The following charts show the percentage of megawatt hour (MWh) sales and sales revenue in 2009, 2008, and 2007 by surplus energy sales (Surplus), commercial and industrial (C&I), and residential (Res) customers:





Operating Expenses

2009 Compared to 2008 Operating Expenses were $1.2 billion in 2009, approximately $139 million lower than in 2008. Purchased Power expense was $107 million lower in 2009 mainly due to lower average prices and less energy purchased as compared to 2008. Approximately three percent less energy was purchased in 2009 at average prices that were 22 percent lower than in 2008. Purchased Power expense increased by $4 million for precipitation hedges and insurance. In 2009, net fuel costs for generation, a component of Production Costs, were approximately $271 million, or $34 million higher than 2008. Less fuel was used in 2009 (5.4 million decatherms), primarily due to lower production at all of the component unit cogeneration plants (14 percent). Average net fuel prices were 30 percent higher in 2009 as compared to 2008.

These reductions were partially offset by higher Administrative, General and Customer expenses, which were $6 million higher in 2009 than in 2008.

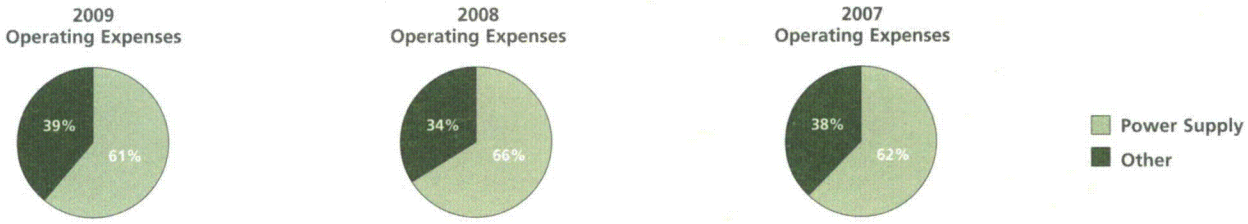
Depreciation expense increased by $7 million due to a change in the remaining service life for meters as SMUD transitions to advanced metering technology and due to normal capital plant additions.

In 2009, power supply costs made up approximately 61 percent of total Operating Expenses as compared to 66 percent for 2008.

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.

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 2009, 2008, and 2007:



Other Revenues

2009 Compared to 2008 Other Revenues were $10 million lower in 2009 as compared to 2008. Interest Income was $18 million lower due to significantly lower interest rates and lower securities lending income.

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.

Interest Charges

2009 Compared to 2008 Interest Charges in 2009 were $41 million lower than in 2008, due mainly to a gain on the extinguishments of a portion of the NCGA long-term debt. This also resulted in lower Interest on Debt for 2009.

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.

Extraordinary Income SMUD also recognized Extraordinary Income in 2009 of $17 million due to a natural gas anti-trust litigation settlement that was deferred from 2008, as compared to Extraordinary Income of $10 million that was recognized in 2008 due to the natural gas anti-trust litigation and a bankruptcy settlement related to purchased power.

CONSOLIDATED BALANCE SHEETS

Assets	December 31, 2009	2008
	(thousands of dollars)	
Electric Utility Plant		
Plant in service	$ 4,342,758	$ 4,186,435
Less accumulated depreciation and depletion	(1,608,459)	(1,496,838)
Plant in service – net	2,734,299	2,689,597
Construction work in progress	244,324	237,149
Total electric utility plant – net	2,978,623	2,926,746
Restricted and Designated Assets		
Revenue bond, debt service and construction reserves	208,663	260,893
Nuclear decommissioning trust fund	38,849	38,333
Rate stabilization fund	47,688	74,775
Securities lending collateral	5,247	31,400
Other funds	805	805
Less current portion	(98,757)	(132,087)
Total restricted and designated assets	202,495	274,119
Current Assets		
Unrestricted cash and cash equivalents	257,648	192,289
Restricted and designated cash and cash equivalents	49,981	78,422
Restricted and designated investments	48,776	53,665
Receivables – net:		
Retail customers	150,811	145,147
Wholesale	40,743	42,397
Energy efficiency loans due within one year, interest receivable and other	25,008	21,556
Regulatory costs to be recovered within one year	98,980	98,363
Derivative financial instruments maturing within one year	18,856	10,222
Materials and supplies	47,526	54,294
Prepaid gas to be delivered within one year	22,114	22,102
Prepayments	25,873	20,099
Total current assets	786,316	738,556
Noncurrent Assets and Deferred Charges		
Regulatory costs for future recovery	265,338	267,608
Prepaid Gas	427,355	699,705
Advance capacity payments	21,713	26,631
Derivative financial instruments	38,761	52,620
Unamortized debt issuance costs	32,368	36,264
Energy efficiency loans – net	60,497	58,684
Preliminary project studies and other	13,635	17,735
Total noncurrent assets and deferred charges	859,667	1,159,247
Total Assets	$ 4,827,101	$ 5,098,668

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

CONSOLIDATED BALANCE SHEETS

Liabilities	December 31, 2009	2008
	(thousands of dollars)	
Long-Term Debt – net	$ 3,010,567	$ 3,205,101
Current Liabilities and Deferred Credits		
Commercial paper notes	200,000	200,000
Accounts payable	77,105	85,718
Purchased power payable	70,491	69,491
Credit support collateral obligation	6,050	11,050
Long-term debt due within one year	106,775	103,845
Accrued decommissioning	6,913	6,913
Interest payable	46,299	52,995
Accrued salaries and compensated absences	33,943	32,212
Derivative financial instruments maturing within one year	93,471	82,934
Regulatory credits to be recognized within one year	13,549	31,018
Securities lending collateral obligation	5,247	31,400
Customer deposits and other	30,066	32,729
Total current liabilities and deferred credits	689,909	740,305
Noncurrent Liabilities and Deferred Credits		
Accrued decommissioning	158,436	170,572
Derivative financial instruments	137,948	158,754
Regulatory credits	271,482	288,445
Due to affiliated entity	13,041	10,572
Due to U.S. Bureau of Reclamation	6,400	5,508
Self insurance, deferred credits and other	23,384	8,862
Total noncurrent liabilities and deferred credits	610,691	642,713
Total Liabilities	4,311,167	4,588,119
Net Assets		
Invested in capital assets, net of related debt	219,329	273,555
Restricted	86,321	121,797
Unrestricted	210,284	115,197
Total Net Assets	515,934	510,549
Commitments and Contingencies (Notes 17 and 18)		
Total Liabilities and Net Assets	$ 4,827,101	$ 5,098,668

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

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Year Ended December 31, 2009	2008
	(thousands of dollars)	
Operating Revenues		
Residential	$ 514,320	$ 517,127
Commercial and industrial	604,907	621,058
Street lighting and other	26,344	29,932
Wholesale	119,956	309,916
Senate Bill - 1 revenue (deferral)	722	(7,722)
Rate stabilization fund transfers	27,088	16,368
Total operating revenues	1,293,337	1,486,679
Operating Expenses		
Operations:		
Purchased power	339,310	446,302
Production	391,177	430,563
Transmission and distribution	50,175	50,005
Administrative, general and customer	142,860	136,457
Public good	47,784	44,802
Maintenance	74,706	76,284
Depreciation	150,811	143,980
Depletion	12,188	14,443
Decommissioning	421	4,700
Regulatory deferrals collected in rates	-0-	1,216
Total operating expenses	1,209,432	1,348,752
Operating Income	83,905	137,927
Non-Operating Revenues and Expenses		
Other revenues		
Interest income	12,326	29,841
Other income – net	15,725	8,524
Total other revenues	28,051	38,365
Interest charges		
Interest on debt	156,258	167,301
(Gain) or loss on debt extinguishment and refundings	(28,320)	287
Allowance for funds used during construction	(4,197)	(3,266)
Total interest charges	123,741	164,322
Increase (decrease) in Net Assets before Extraordinary Income	(11,785)	11,970
Extraordinary Income		
Natural gas and power settlement proceeds	17,170	10,168
Increase in Net Assets	5,385	22,138
Net Assets – Beginning of Year	510,549	488,411
Net Assets – End of Year	$ 515,934	$ 510,549

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2009	2008
	(thousands of dollars)	
Cash Flows From Operating Activities		
Receipts from retail customers	$ 1,127,952	$ 1,155,303
Receipts from surplus power sales	59,225	170,335
Receipts from surplus gas sales	63,646	137,470
Receipts from steam sales	8,013	12,398
Natural gas and power settlement proceeds	702	26,636
Other receipts/payments	7,921	(4,508)
Repayment/receipts for credit support collateral, net	(8,450)	(28,650)
Issuance/repayment of energy efficiency loans, net	(5,313)	(9,007)
Payments to employees – payroll and other	(223,857)	(219,213)
Payments for wholesale power	(326,611)	(471,132)
Payments for gas purchases	(312,350)	(353,789)
Payments to vendors/others	(154,878)	(157,683)
Payments/receipts for weather hedge/insurance	(4,218)	22,097
Payments for decommissioning	(3,859)	(30,389)
Net cash provided by operating activities	227,923	249,868
Cash Flows From Noncapital Financing Activities		
Repayment of debt	(24,085)	(18,665)
Proceeds from extinguishment of long-term debt	20,529	-0-
Receipts from federal and state grants	7,184	1,026
Other receipts	528	656
Interest on debt	(23,542)	(33,035)
Net cash used in noncapital financing activities	(19,386)	(50,018)
Cash Flows From Capital Financing Activities		
Construction expenditures	(211,234)	(224,300)
Contributions in aid of construction	18,813	18,972
Net proceeds from bond issues	310,276	738,910
Repayments and refundings of debt	(218,322)	(694,938)
Issuance of commercial paper	-0-	50,000
Interest on debt	(133,960)	(128,499)
Net cash used in capital financing activities	(234,427)	(239,855)
Cash Flows From Investing Activities		
Sales and maturities of securities	239,480	300,861
Purchases of securities	(142,055)	(215,875)
Interest and dividends received	12,749	31,821
Securities lending collateral – net	(26,153)	(43,884)
Net cash provided by investing activities	84,021	72,923
Net increase in cash and cash equivalents	58,131	32,918
Cash and cash equivalents at the beginning of the year	412,708	379,790
Cash and cash equivalents at the end of the year	$ 470,839	$ 412,708
Cash and cash equivalents included in:		
Unrestricted cash and cash equivalents	$ 257,648	$ 192,289
Restricted and designated cash and cash equivalents	49,981	78,422
Revenue bond, debt service and construction reserves (a component of the total of $208,663 and $260,893 at December 31, 2009 and 2008, respectively)	163,210	141,997
Cash and cash equivalents at the end of the year	$ 470,839	$ 412,708

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

SUPPLEMENTAL CASH FLOW INFORMATION

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

	Year Ended December 31, 2009	2008
	(thousands of dollars)	
Operating income	$ 83,905	$ 137,927
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	150,811	143,980
Depletion	12,188	14,443
Regulatory deferrals collected in rates, including decommissioning	421	5,916
Amortization of advance capacity & other	5,431	4,990
Amortization of prepaid gas supply	21,350	22,220
Revenue (recognized from) deferred to regulatory credits, net	(28,447)	(9,816)
Natural gas and power settlement proceeds	702	26,636
Repayment/receipts for credit support collateral, net	(8,450)	(28,650)
Other receipts/payments	7,632	(217)
Changes in operating assets and liabilities:		
Customer and wholesale receivables	(2,749)	(9,636)
Energy efficiency loans	(5,313)	(9,007)
Other assets	4,016	(12,299)
Payables and accruals	(9,715)	(6,230)
Decommissioning	(3,859)	(30,389)
Net cash provided by operating activities	$ 227,923	$ 249,868

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

	Year Ended December 31, 2009	2008
	(thousands of dollars)	
Gain or (Loss) on debt extinguishment and refundings	7,791	(287)
Amortization of debt related costs	(2,355)	(3,496)
Unrealized holding gain or (loss)	(301)	197
Change in valuation of derivative financial instruments	(5,043)	(261,224)
Amortization of revenue for assets contributed in aid of construction	8,689	8,135
Allowance for funds used during construction	4,197	3,266
Construction costs included in accounts payable	32,443	29,284
Extinguishment of long-term debt	259,840	-0-
Partial termination of prepaid gas supply	(250,988)	-0-

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

NOTE 1. ORGANIZATION

The Sacramento Municipal Utility District (SMUD) was formed and operates under the State of California Municipal Utility District Act (Act). The Act confers upon SMUD 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, SMUD is not subject to regulation or oversight by the California Public Utilities Commission. SMUD 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 SMUD's rates. SMUD 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. SMUD's accounting records are maintained in accordance with Generally Accepted Accounting Principles (GAAP) 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). References to GAAP issued by the FASB in these footnotes are to the *FASB Accounting Standards Codification*™, sometimes referred to as the Codification or ASC. The FASB finalized the Codification for periods ending on or after September 15, 2009. Prior FASB standards like FASB No. 157, "Fair Value Measurements", are no longer being issued by the FASB. For further discussion of the Codification see "FASB Codification Discussion" in Management's Discussion and Analysis elsewhere in this report. SMUD'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. SMUD'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 SMUD and its component units. Although the component units are legally separate from SMUD, they are blended into and reported as part of SMUD because of the extent of their operational and financial relationships with SMUD. 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 SMUD. The primary purpose of NCGA is to prepay for natural gas and to sell the natural gas to SMUD. SMUD'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 SMUD 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. SMUD generally computes depreciation on Plant in Service on a straight-line, service-life basis. The consolidated average annual composite depreciation rates for 2009 and 2008 were 3.72 and 3.69 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
Gas Pipeline	5 to 90 years

Investments in Joint Power Agency (JPA). SMUD'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. SMUD'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. SMUD has an approximate 23 percent non-operating ownership interest in the Rosa Unit gas properties in New Mexico of which, SMUD's portion of the extracted gas is transported for use in its component unit natural gas-fired power plants (see Note 6). SMUD 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. SMUD'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. When SMUD restricts funds for a specific purpose, and both restricted and unrestricted resources are available for use, it is SMUD's policy to use restricted resources first, then unrestricted resources as they are needed.

Restricted Bond Funds. SMUD'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. SMUD 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. SMUD 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 SMUD's annual contribution to the Trust Fund and the interest earnings on Trust Fund assets during the year.

Accrued Decommissioning. SMUD 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 SMUD staff in accordance with FASB ASC 410, *Asset Retirement and Environmental Obligations* (FASB ASC 410), (formerly known as 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 SMUD's estimate of actual expenditures in the next year, as set forth in the annual budget.

SMUD has identified potential retirement obligations related to certain generation, distribution and transmission facilities. SMUD's non-perpetual leased land rights generally are renewed continuously because SMUD 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, 2009 and 2008, SMUD's Accrued Decommissioning balance in the Consolidated Balance Sheets relating to Rancho Seco was $158.8 million and $171.4 million, respectively (see Note 13). The Accrued Decommissioning balance in the Consolidated Balance Sheets relating to other electricity generation and gas production facilities totaled $6.5 million and $6.1 million as of December 31, 2009 and 2008, respectively.

Securities Lending Transactions. SMUD 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. SMUD 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. SMUD'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. SMUD'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. SMUD 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, 2009 and 2008, unbilled revenues were $64.3 million and $63.1 million, respectively.

Purchased Power Expenses. A portion of SMUD'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 or capacity 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. SMUD enters into forward purchase and sales commitments for physical delivery of gas and electricity with utilities and power marketers. SMUD is exposed to credit risk related to nonperformance by its wholesale counterparties under the terms of these contractual agreements. In order to limit the risk of counterparty default, SMUD has a wholesale counterparty evaluation policy which includes the assignment of internal credit ratings to SMUD'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. SMUD is also subject to similar requirements for many of its gas and electricity purchase agreements. As of December 31, 2009 and 2008, SMUD held $6.1 million and $11.1 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, 2009, SMUD had $11.0 million in collateral on deposit with counterparties. SMUD has a $50 million letter of credit facility to support collateral requirements under SMUD'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 efficiency loans. SMUD recognizes an estimate of uncollectible accounts for its receivables related to electric service, wholesale activities, and energy efficiency loans based upon its historical experience with collections and current energy market conditions. For large wholesale receivable balances, SMUD determines its bad debt reserves based on the specific credit issues for each account. SMUD 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. SMUD records bad debts for its estimated uncollectible accounts related to energy efficiency 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 2009 and 2008 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, 2009	$ 24,582	$ 237	$ 971	$ 23,848
December 31, 2008	$ 24,242	$ 388	$ 48	$ 24,582
Wholesale Power and Other:				
December 31, 2009	$ 1,681	$ 400	$ 563	$ 1,518
December 31, 2008	$ 1,249	$ 640	$ 208	$ 1,681
Retail Customers:				
December 31, 2009	$ 2,882	$ 6,617	$ 5,951	$ 3,548
December 31, 2008	$ 4,179	$ 4,600	$ 5,897	$ 2,882
Energy Efficiency Loans:				
December 31, 2009	$ 2,349	$ 2,351	$ 1,722	$ 2,978
December 31, 2008	$ 1,729	$ 2,052	$ 1,432	$ 2,349

Regulatory Deferrals. The Board has the authority to establish the level of rates charged for all SMUD services. As a regulated entity, SMUD's financial statements are prepared in accordance with FASB ASC 980, *Regulated Operations* (FASB ASC 980), formerly known as SFAS 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. SMUD 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 effective interest method.

Compensated Absences. SMUD accrues vacation leave and compensatory time when employees earn the rights to the benefits. SMUD 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, 2009 and 2008, the total estimated liability for vacation and other compensated absences was $24.4 million and $23.5 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 effective interest method.

Gains/Losses on Bond Defeasances or Extinguishments. Gains and losses resulting from bond defeasances or extinguishments 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). SMUD 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 2009 and 2008 were 3.5 percent and 3.2 percent, respectively, of eligible CWIP.

Derivative Financial Instruments. SMUD 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. SMUD generally does not enter into agreements for trading purposes; however, SMUD 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. SMUD is exposed to risk of nonperformance if the counterparties default or if the swap agreements are terminated. SMUD 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. SMUD 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. SMUD 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 SMUD'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. SMUD enters into non-exchange traded precipitation hedge agreements to hedge the increased cost of power caused by low precipitation years (Precipitation Agreements). SMUD 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. SMUD records liabilities for unpaid claims at their present value when they are probable in occurrence and the amount can be reasonably estimated. SMUD records a liability for unpaid claims associated with general, auto, workers' compensation, and short-term and long-term disability based upon estimates derived by SMUD's claims administrator or SMUD staff. The liability comprises the present value of the claims outstanding, and includes an amount for claim events incurred but not reported based upon SMUD's experience.

Net Assets. SMUD 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). SMUD records CIAC from customer contributions, primarily relating to expansions to SMUD'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. SMUD receives grant proceeds from federal and state assisted programs for its advanced and renewable technologies, electric vehicle, and energy efficiency programs. SMUD also periodically receives grant proceeds from federal or state assistance 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. SMUD considers the possibility of any material disallowances to be remote. During 2009 and 2008, SMUD recognized grant proceeds of $4.9 million and $1.1 million, respectively, as a component of Interest and Other Income, in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets. In 2009, SMUD issued taxable Build America Bonds. SMUD will receive an interest subsidy from the federal government equal to 35 percent of the interest paid. (Note 10) In 2009, SMUD recognized $2.8 million in revenues for its Build America Bonds, as a component of Interest and Other Income, in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets.

Extraordinary Income. During 2008 and 2009, SMUD received several settlements that were considered extraordinary income. SMUD 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. The deferred amount was recognized equally in January through March of 2009, and an additional $0.4 million was received in 2009 related to the litigation. SMUD also received $0.3 million in 2009 and $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. SMUD 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.

SMUD 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, 2009, seven employees had retention agreements totaling $0.3 million, recorded as a component of Customer Deposits and Other on the Consolidated Balance Sheets.

In October 2009, SMUD announced that the installation of "Smart Meters" would affect certain job classifications. A separation package and talent retention program was outlined with employees. Benefits provided include up to 12 weeks of paid leave, plus pay in lieu of benefits for up to 12 weeks. Because the affected employees must work through August 2010, the amount of the termination liability is being recognized ratably on a monthly basis through August 2010. As of December 31, 2009, there were approximately 98 positions affected, and SMUD had a termination liability of $0.3 million, recorded as a component of Customer Deposits and Other on the Consolidated Balance Sheets.

Reclassifications. Certain amounts in the 2008 consolidated financial statements have been reclassified in order to conform to the 2009 presentation.

Recent Accounting Pronouncements. In November 2006, GASB issued Statement of Government Accounting Standards (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 SMUD beginning in 2008. In December 2009, SMUD identified a pollution remediation obligation at its North City Substation. This substation was built on a former landfill, and the site requires remediation. As part of the 2010 Budget Resolution, the Board authorized SMUD to defer the expense for rate-making purposes, and SMUD recorded a pollution remediation liability of $12.0 million and a corresponding regulatory asset for the remediation project. See Note 8.

In June 2007, GASB issued SGAS No. 51, "*Accounting and Financial Reporting for Intangible Assets*" (GASB No. 51). GASB No. 51 provides guidance regarding how to identify, account for and report intangible assets. Intangible assets are defined as assets that lack physical substance, are nonfinancial in nature, and have an initial useful life extending beyond a single reporting period. 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 SMUD beginning in 2010. SMUD has assessed the financial statement impact of adopting the new statement, and its impact will not be material.

In June 2008, GASB issued SGAS No. 53, "Accounting and Financial Reporting for Derivative Instruments" (GASB No. 53). GASB No. 53 provides a comprehensive framework for the measurement, recognition and disclosure of derivative financial instrument transactions entered into by state and local governments. The statement requires that all derivative financial instruments be measured at fair value which will be reported on the Balance Sheet, and that all derivative financial instruments are tested for effectiveness. The change in valuation of ineffective hedges should be reported as Investment Revenue on the Consolidated Statements of Revenues, Expenses and Changes in Net Assets. This statement is effective for SMUD beginning in 2010. Currently, SMUD follows FASB ASC 815, *Derivatives and Hedging* (FASB ASC 815), formerly known as SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*", and does not elect hedge accounting. SMUD 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 March 2009, GASB issued SGAS No. 55, "The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments" (GASB No. 55). GASB No. 55 incorporates the hierarchy of GAAP for state and local governments into the GASB's authoritative literature. Prior to this standard, the GAAP hierarchy was included in an American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards, rather than in the GASB's literature. This statement was effective for SMUD upon issuance and will not have a material impact on SMUD's financial statements.

In March 2009, GASB issued SGAS No. 56, "Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards" (GASB No. 56). GASB No. 56 incorporates certain accounting and financial reporting guidance presented in the AICPA's Statements on Auditing Standards into the GASB's authoritative literature. This statement was effective for SMUD upon issuance and will not have a material impact on SMUD's financial statements.

In December 2009, GASB issued SGAS No. 57, "OPEB Measurements by Agent Employers and Agent Multiple – Employer Plans" (GASB No. 57). GASB No. 57 addresses issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer OPEB plans. The statement amends previous GASB statements on OPEB plans, and will improve the consistency of reporting for OPEB plans. This statement is effective for SMUD for 2012. SMUD 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 September 2006, the FASB issued FASB ASC 820, *Fair Value Measurements and Disclosures* (FASB ASC 820), formerly known as SFAS No. 157, "*Fair Value Measurements*". FASB ASC 820 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 was effective for SMUD beginning in 2008 (see Note 3).

Effective in 2009, SMUD adopted an amendment to FASB ASC 820, formerly known as FASB Staff Position FAS 157-2 "*Effective Date of FASB Statement No. 157,*" which requires calculation of the fair market value of AROs that are measured on a nonrecurring basis. See Note 12.

In March 2008, FASB amended FASB ASC 815. FASB ASC 815 seeks to improve financial reporting for derivative instruments and hedging activities by requiring enhanced disclosures regarding a company's hedging strategies, the impact on financial position, financial performance and cash flows. To achieve this increased transparency, FASB ASC 815 requires (1) the disclosure of the rationale for hedging; (2) the disclosure of the fair value of derivative instruments and gains and losses in a tabular format; (3) the disclosure of derivative features that are credit risk-related; and (4) crossreferencing within the footnotes. FASB ASC 815 was effective for SMUD on January 1, 2009. Refer to Note 9.

In May 2009, the FASB issued FASB ASC 855, *Subsequent Events* (FASB ASC 855). FASB ASC 855 establishes standards of accounting and disclosure for events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This statement introduces the concept of financial statements being "available to be issued", and requires that an entity disclose the date that through which it has evaluated subsequent events. This statement is effective for SMUD for 2009. Subsequent events for SMUD have been evaluated through February 19, 2010, which is the date that the financial statements were available to be issued.

In June 2009, the FASB issued FASB ASC 105, *Generally Accepted Accounting Principles* (FASB ASC 105), which establishes the FASB Accounting Standards Codification as the sole source of authoritative GAAP. Pursuant to the provisions of FASB ASC 105, SMUD has updated references to GAAP in its financial statements issued for the period ended December 31, 2009. The adoption of FASB ASC 105 did not impact SMUD's financial position or results of operations.

In August 2009, the FASB Issued Accounting Standards Update (ASU) No. 2009-05, *Fair Value Measurements and Disclosures relating to FASB ASC 820.* This update requires that the fair value of liabilities be measured under the assumption that the liability is transferred to a market participant, and provides guidance on how to estimate the fair value of a liability. This statement is effective for SMUD in 2009.

NOTE 3. ACCOUNTING CHANGE

FASB ASC 820. Effective January 1, 2008, SMUD adopted FASB ASC 820, 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 is January 1, 2009.

FASB ASC 820 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 ASC 820 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 SMUD's own assumptions developed from the best information available in the circumstances. FASB ASC 820 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.

NOTE 4. UTILITY PLANT

The summarized activity of SMUD's utility plant during 2009 is presented below (thousands of dollars):

	Balance December 31, 2008	Additions	Transfers and Deletions	Balance December 31, 2009
Nondepreciable Utility Plant:				
Land	$ 96,859	$ 5,869	$ (1,470)	$ 101,258
CWIP	237,149	213,358	(206,183)	244,324
Total nondepreciable utility plant	334,008	219,227	(207,653)	345,582
Depreciable Utility Plant:				
Generation	1,386,758	41,081	(4,508)	1,423,331
Transmission	204,739	21,801	(5,317)	221,223
Distribution	1,501,004	93,278	(6,546)	1,587,736
Investment in gas properties	180,561	6,263	-0-	186,824
Investment in JPAs	11,836	-0-	(1,445)	10,391
General	804,678	42,657	(35,340)	811,995
	4,089,576	205,080	(53,156)	4,241,500
Less: accumulated depreciation and depletion	(1,493,316)	(162,578)	51,270	(1,604,624)
Less: accumulated amortization on JPAs	(3,522)	(313)	-0-	(3,835)
	(1,496,838)	(162,891)	51,270	(1,608,459)
Total depreciable plant	2,592,738	42,189	(1,886)	2,633,041
Total Utility Plant – net	$ 2,926,746	$ 261,416	$ (209,539)	$ 2,978,623

The summarized activity of SMUD'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

NOTE 5. INVESTMENT IN JOINT POWERS AGENCY

TANC. SMUD 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. SMUD is obligated to pay approximately 30.0 percent of TANC's COTP debt service and operations costs in exchange for entitlement to approximately 419 megawatts (MW) of TANC's 1,390 MW transfer capability. Additionally, SMUD has a 48 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 (SOT).

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. SMUD received an additional entitlement to 36 MW of the COTP and 2 MW of SOT, both of which are included in the 419 MW COTP and 48 MW SOT totals, respectively. In December 2009, SMUD entered into a long-term reallocation agreement with TANC and the City of Santa Clara. Effective January 2010, through 2013, SMUD will have an additional 30 MW, which will make SMUD's entitlement a 78 MW share of the SOT.

The long-term debt of TANC, which totals $435.8 million (unaudited) at December 31, 2009, is collateralized by a pledge and assignment of net revenues of TANC supported by take-or-pay commitments of SMUD and other members. Should other members default on their obligations to TANC, SMUD would be required to make additional payments to cover a portion of such defaulted payments, up to 25 percent of its current obligation.

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

SMUD recorded transmission expenses related to TANC of $18.0 million and $15.7 million in 2009 and 2008, respectively.

Summary financial information for TANC is presented below:

	December 31, 2009 (unaudited)	December 31, 2008 (unaudited)
	(thousands of dollars)	
Total assets	$ 491,624	$ 484,878
Total liabilities	488,030	$ 476,599
Total net assets	3,594	8,279
Total liabilities and net assets	491,624	$ 484,878
Changes in net assets for the six months ended December 31	$ (82)	$ (1,919)

Balancing Authority of Northern California (BANC). SMUD and three other California municipal utilities formed BANC, a JPA, in 2009. BANC was formed to perform North American Electric Reliability Corporation (NERC) functions that would otherwise be performed by the BANC members or on their behalf.

	December 31, 2009 (unaudited)
	(thousands of dollars)
Total assets	$ 172
Total liabilities	$ 172
Total net assets	-0-
Total liabilities and net assets	$ 172
Changes in net assets for the five months ended December 31	$ -0-

SMUD recorded expenses related to BANC of $0.15 million in 2009.

NOTE 6. COMPONENT UNITS

CVFA Carson Cogeneration Project. CVFA is a JPA formed by SMUD 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. The revenue stream to pay the CVFA bonds' debt service is provided by a take or pay purchase power agreement between SMUD and CVFA.

SCA Procter & Gamble Cogeneration Project. SCA is a JPA formed by SMUD and the SFA. SCA operates the Procter & Gamble Project, a 136 MW (net) natural gas-fired cogeneration facility and a 44 MW (net) natural gas-fired simple cycle peaking plant The revenue stream to pay the SCA bonds' debt service is provided by a take or pay purchase power agreement between SMUD and SCA.

SFA Cosumnes Power Plant Project. SFA is a JPA formed by SMUD 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.

SPA Campbell Soup Cogeneration Project. SPA is a JPA formed by SMUD 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, and the McClellan Project, a 72 MW (net) natural gas-fired simple cycle peaking plant.

NCGA. NCGA is a JPA formed by SMUD 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. SMUD 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. SMUD 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 and August 2009, some NCGA bonds were extinguished.

As described in Note 2, all of the activities and balances of the component units are blended into and reported as part of SMUD because of the extent of their operational and financial relationships with SMUD. 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. SMUD's investment policies are governed by the California State and Municipal Codes and its Indenture, which restricts SMUD's 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. SMUD'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, SMUD 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, SMUD's deposits may not be returned or SMUD will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of another party. SMUD does not have a deposit policy for custodial credit risk. At December 31, 2009, $5.2 million in money market funds, and at December 31, 2008 $31.4 million in repurchase agreements, were held by a counterparty that was acting as SMUD'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 SMUD's commercial cash deposits were fully insured at December 31, 2009. The bank balance is also, per a depository pledge agreement between SMUD and SMUD's bank, collateralized at 649 percent of the collected funds on deposit (increased by the amount of accrued but uncredited interest, reduced by deposits covered by FDIC). SMUD's investments are held in SMUD'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. SMUD 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 five percent in either year:

	December 31, 2009	2008
Investment Type:		
Federal National Mortgage Association (Fannie Mae)	5%	0%
Federal Home Loan Banks	5%	8%
Federal Home Loan Mortgage Corporation (Freddie Mac)	0%	6%
Banker's Acceptance – Bank of America	0%	5%
Commercial Paper – General Electric	0%	5%
CS First Boston Repurchase Agreements	0%	5%
Federal Farm Credit Bonds	0%	5%
Certificate of Deposit – US Bank	0%	7%
Certificate of Deposit – Bank of the West	0%	5%

Interest Rate Risk. This is the risk of loss due to the fair value of an investment falling due to interest rates rising. Though SMUD 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. SMUD 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 2009 or 2008. The maturities of the investments made match the maturities of the securities loaned, which are U.S. Treasuries and Agencies. At December 31, 2009 and 2008, SMUD had no credit risk exposure to borrowers because the amount SMUD owes the borrowers exceeds the amounts the borrowers owe SMUD. The contract with SMUD's custodial bank requires it to indemnify SMUD if the borrowers fail to return the securities (and the collateral is inadequate to replace the securities lent), or fail to pay SMUD for income distributions by the securities' issuers while the securities were on loan. SMUD cannot pledge or sell collateral securities without borrower default. SMUD receives cash collateral and invests in certain securities allowed for in the securities lending agreement. These investments were in money market funds in the amount of $5.2 million as of December 31, 2009. The fair market value equals the carrying amount for the money market funds.

Interest Rate Swap Agreement. SMUD 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, SMUD 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 SMUD on January 3, 2008. SMUD received a $3.7 million termination payment.

The following schedules indicate the credit and interest rate risk at December 31, 2009 and 2008. The credit ratings listed are from S&P. (N/A is defined as not applicable to the rating disclosure requirements).

At December 31, 2009, SMUD'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:					
Cash Deposits	N/A	$ 10,544	$ -0-	$ -0-	$ 10,544
LAIF	Not Rated	255,056	-0-	-0-	255,056
Money Market Mutual Funds	AAAm	141,959	-0-	-0-	141,959
Fannie Mae	AAAm	17,999	-0-	-0-	17,999
Bankers Acceptance	A-1+	4,100	-0-	-0-	4,100
Commercial Paper	A-1	35,934	-0-	-0-	35,934
Money Market Funds	AAA	5,247	-0-	-0-	5,247
Total cash and cash equivalents		470,839	-0-	-0-	470,839
Investments:					
Fannie Mae	AAA	-0-	9,972	-0-	9,972
Federal Home Loan Banks	AAA	20,007	10,028	-0-	30,035
Freddie Mac	AAA	-0-	2,164	-0-	2,164
Bankers Acceptance	A-1+	9,998	-0-	-0-	9,998
United States Treasuries	N/A	-0-	20,667	-0-	20,667
Corporate Note	AAA/AA+	-0-	15,225	-0-	15,225
Total investments		30,005	58,056	-0-	88,061
Total cash, cash equivalents and investments		$ 500,844	$ 58,056	$ -0-	$ 558,900

At December 31, 2008, SMUD'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, 2008, SMUD reported its book overdraft of $0.9 million as a component of Accounts Payable on the Consolidated Balance Sheets. There was no book overdraft at December 31, 2009.

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

	December 31, 2009	December 31, 2008
	(thousands of dollars)	
Total Cash, Cash Equivalents and Investments:		
Revenue bond reserve, debt service and construction funds:		
Revenue bond reserve fund	$ 56,740	$ 61,285
Debt service fund	48,026	52,915
Component unit bond reserve and construction funds	103,897	146,693
Total revenue bond reserve, debt service and construction funds	208,663	260,893
Nuclear decommissioning trust fund	38,849	38,333
Rate stabilization fund	47,688	74,775
Securities lending collateral	5,247	31,400
Other restricted funds	805	805
Unrestricted funds	257,648	192,289
Total cash, cash equivalents and investments	$ 558,900	$ 598,495

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. SMUD'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 being collected in rates starting in 2009.

Wholesale Power Receivables. SMUD'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 $23.8 million and $24.6 million at December 31, 2009 and 2008, 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. SMUD'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, SMUD 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. SMUD 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 SMUD is committed to making the increased rate payments to the Bureau.

Derivative Financial Instruments. SMUD'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. Derivative financial instruments 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.

Pollution Remediation. With the adoption of the 2010 Budget Resolution, SMUD established a regulatory asset to defer recognition of the expense related to the investigation, design and remediation necessary for the North City Substation site. SMUD has recorded a liability for the full $12.0 million estimated for the project under GASB No. 49. This regulatory asset will be collected in rates in 2012 and 2013.

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

	December 31, 2009	December 31, 2008
	(thousands of dollars)	
Regulatory Costs for Future Recovery:		
Decommissioning	$ 132,567	$ 143,622
Wholesale power receivables	23,848	24,582
TANC operations costs	13,041	10,572
U.S. Bureau of Reclamation	6,400	5,508
Derivative financial instruments	176,462	181,687
Pollution remediation	12,000	-0
Total regulatory costs	364,318	365,971
Less: regulatory costs to be recovered within one year	(98,980)	(98,363)
Total regulatory costs for future recovery – net	$ 265,338	$ 267,608

Regulatory Liabilities (Credits)

CIAC. In 2009 and 2008 SMUD capitalized CIAC totaling $18.8 million and $19.0 million, respectively, in Plant in Service in the Consolidated Balance Sheets and recorded $8.7 million and $8.1 million, respectively, of Depreciation Expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets. SMUD'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. SMUD'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 2009, $10.9 million from the HRSF was recognized as revenue to cover the budget impact of low precipitation.

Public Good. SMUD'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, SMUD received several payments related to a natural gas antitrust litigation settlement. Of the total received, $16.5 million was deferred and recognized as revenue in 2009 per Board Resolution.

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.

Senate Bill 1. During 2007, SMUD implemented a per kilowatt hour solar surcharge, 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, SMUD spent less than it collected in SB-1 revenues, and has recorded a regulatory credit.

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

	December 31, 2009	December 31, 2008
	(thousands of dollars)	
Regulatory Credits for Future Revenue Recognition:		
CIAC	$ 229,694	$ 219,570
Rate stabilization	43,605	59,775
Hydro rate stabilization	4,083	15,000
Public good	290	928
Litigation settlement	-0-	16,468
Precipitation hedges	359	-0-
SB-1	7,000	7,722
Total regulatory credits for future revenue recognition	285,031	319,463
Less: regulatory credits to be recognized within one year	(13,549)	(31,018)
Total regulatory credits – net	$ 271,482	$ 288,445

NOTE 9. DERIVATIVE FINANCIAL INSTRUMENTS

To help provide stable electric rates and to meet the forecasted power needs of its retail customers reliably, SMUD enters into various physical and financial fixed price purchase contracts for electricity and natural gas. These fixed price contracts and swap agreements are intended to hedge the exposure due to highly volatile and fluctuating commodity prices. SMUD also enters into interest rate swap agreements to reduce interest rate risk, or to enhance the relationship between the risk and return regarding SMUD's assets or debt obligations.

During 2009 and 2008, SMUD executed numerous new gas related and power related purchase agreements, some of which are recorded as derivative financial instruments and are therefore included in the table below. All derivative financial instruments are recorded at fair value on our Consolidated Balance Sheets.

SMUD utilizes these derivative financial instruments to mitigate its exposure to certain market risks associated with our ongoing operations. It should be noted that SMUD does not use derivative financial instruments for trading or speculative purposes.

These hedged risks include those related to interest rate and commodity price fluctuations associated with certain forecasted transactions, including interest rate risk on our long term debt, and forward purchases of gas and electricity to meet our load. Changes in the fair value of all of SMUD's derivative financial instruments that would be recorded on the Consolidated Statements of Revenues, Expenses and Changes in Net Assets are deferred for rate-making purposes as regulatory assets or liabilities on the Consolidated Balance Sheets (Note 8).

SMUD is exposed to counterparty credit risk on all of our derivative financial instruments. SMUD has established and maintained strict counterparty credit guidelines and enters into contracts only with institutions that are investment grade or better. SMUD continuously monitors counterparty credit risk, and utilizes numerous counterparties to minimize exposure to potential defaults. Under certain conditions as outlined in our credit risk management policy, SMUD may require collateral under these agreements.

Some of SMUD's derivative master agreements contain credit contingent provisions that enable SMUD to maintain unsecured credit as a result of positive investment quality credit ratings from each of the major credit rating agencies. If SMUD's debt were to fall below investment grade, it would trigger some of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a liability position on December 31, 2009, is $166.1 million, for which SMUD has posted collateral of $49.5 million in the normal course of business. If the credit-risk-related contingent features underlying these agreements were triggered on December 31, 2009, SMUD would be required to post an additional $116.1 million of collateral to its counterparties.

The fair value of SMUD's derivative financial instruments not designated as hedging instruments under FASB ASC 815 are as follows:

	December 31, 2009	December 31, 2008
	(thousands of dollars)	
Assets:		
Derivative Financial Instruments not designated as hedging instruments:		
Balance Sheet Location: Current Assets, Derivative Financial Instruments		
Gas Contracts	$ 16,961	$ 6,794
Electric contracts	-0-	1,037
Interest rate contracts	1,895	2,391
Total Current Assets, Derivative Financial Instruments	18,856	10,222
Balance Sheet Location: NonCurrent Assets and Deferred Charges, Derivative Financial Instruments		
Gas Contracts	13,177	17,955
Electric contracts	-0-	-0-
Interest rate contracts	25,584	34,665
Total NonCurrent Assets and Deferred Charges, Derivative Financial Instruments	38,761	52,620
Total derivative financial instrument assets not designated as hedging instruments	$ 57,617	$ 62,842

	December 31, 2009	December 31, 2008
	(thousands of dollars)	
Liabilities:		
Derivative Financial Instruments not designated as hedging instruments:		
Balance Sheet Location: Current Liabilities, Derivative Financial Instruments maturing within one year		
Gas Contracts	$ 90,121	$ 68,395
Electric contracts	-0-	9,475
Interest rate contracts	3,350	5,064
Total Current Liabilities, Derivative Financial Instruments maturing within one year	93,471	82,934
Balance Sheet Location: NonCurrent Liabilities and Deferred Credits, Derivative Financial Instruments		
Gas Contracts	110,568	108,933
Electric contracts	717	-0-
Interest rate contracts	26,663	49,821
Total NonCurrent Liabilities and Deferred Credits, Derivative Financial Instruments	137,948	158,754
Total derivative financial instrument liabilities not designated as hedging instruments	$ 231,419	$ 241,688

Derivatives not designated as hedging instruments.

Gas Contracts. SMUD utilizes certain gas swap agreements under FASB ASC 815 not designated as hedging instruments to mitigate exposure to changes in the market price of natural gas. The fair value of each agreement, excluding the actual settlements to be paid or received as of the end of the period, is recorded in either Current or NonCurrent Assets, Derivative Financial Instruments on the Consolidated Balance Sheets if in an asset position or Current or NonCurrent Liabilities, Derivative Financial Instruments on the Consolidated Balance Sheets if in a liability position, and an offsetting amount is included in Current or Noncurrent Regulatory Costs or Regulatory Credits for future recovery in the Consolidated Balance Sheets. The actual settlement payable is recorded in Accounts Payable on the Consolidated Balance Sheets, and the actual settlement receivable is recorded in Energy Efficiency loans due within one year, accrued interest and other on the Consolidated Balance Sheets.

Electric Contracts. SMUD utilizes certain electric swap agreements under FASB ASC 815 not designated as hedging instruments to mitigate exposure to changes in the market price of natural gas. The fair value of each agreement, excluding the actual settlements to be paid or received as of the end of the period, is recorded in either Current or NonCurrent Assets, Derivative Financial Instruments on the Consolidated Balance Sheets if in an asset position or Current or NonCurrent Liabilities, Derivative Financial Instruments on the Consolidated Balance Sheets if in a liability position, and an offsetting amount is included in Current or Noncurrent Regulatory Costs or Regulatory Credits for future recovery in the Consolidated Balance Sheets. The actual settlement payable is recorded in Accounts Payable on the Consolidated Balance Sheets, and the actual settlement receivable is recorded in Energy Efficiency Loans due within one year, Accrued Interest and Other on the Consolidated Balance Sheets.

Interest Rate Contracts. SMUD utilizes certain interest rate swap agreements not designated as hedging instruments under FASB ASC 815 to mitigate exposure to changes in the fair value of variable rate debt resulting from fluctuations in interest rates. The fair value of each agreement, excluding the balance of interest to be paid or received as of the end of the period, is recorded in either Current or NonCurrent Assets, Derivative Financial Instruments on the Consolidated Balance Sheets if in an asset position or Current or NonCurrent Liabilities, Derivative Financial Instruments on the Consolidated Balance Sheets if in a liability position, and an offsetting amount is included in Current or Noncurrent Regulatory Costs or Regulatory Credits for future recovery in the Consolidated Balance Sheets. The interest receivable is recorded in Energy Efficiency Loans due within one year, Accrued Interest and Other on the Consolidated Balance Sheets, and the interest payable is recorded Accrued interest on the Consolidated Balance Sheets.

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, 2009.

NOTE 10. LONG-TERM DEBT

SMUD's total long-term debt is presented below:

	December 31, 2009	2008
	(thousands of dollars)	
Electric Revenue Bonds:		
Electric revenue bonds, 2.5%-6.5%, 2010-2033	$ 1,948,645	$ 1,814,480
Subordinated electric revenue bonds, 0.2%-8.0%, 2010-2028	207,850	222,425
Total electric revenue bonds	2,156,495	2,036,905
Component unit project revenue bonds, 2.25%-5.50%, 2010-2030	488,665	519,205
Gas supply prepayment bonds 3.385%-5.0%, 2010-2027	454,465	738,390
Total long-term debt outstanding	3,099,625	3,294,500
Bond premiums – net	89,610	93,303
Deferred losses on bond refundings - net	(71,893)	(78,857)
Total long-term debt	3,117,342	3,308,946
Less: amounts due within one year	(106,775)	(103,845)
Total long-term debt – net	$ 3,010,567	$ 3,205,101

The summarized activity of SMUD's long-term debt during 2009 is presented below (thousands of dollars):

	December 31, 2008	Additions	Payments or Amortization	December 31, 2009	Amounts Due Within One Year
			(thousands of dollars)		
Electric revenue bonds	$ 1,814,480	$ 200,000	$ (80,410)	$ 1,934,070	$ 54,955
Subordinate electric revenue bonds	222,425	-0-	-0-	222,425	10,000
Component unit project revenue bonds	519,205	106,450	(136,990)	488,665	18,355
Gas supply prepayment bonds	738,390	-0-	(283,925)	454,465	23,465
Total	3,294,500	306,450	(501,325)	3,099,625	$ 106,775
Unamortized premiums – net	93,303	7,385	(11,078)	89,610	
Deferred losses on bond refundings – net	(78,857)	(7,575)	14,539	(71,893)	
Total long-term debt	$ 3,308,946	$ 306,260	$ (497,864)	$ 3,117,342	

The summarized activity of the SMUD'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	

At December 31, 2009 scheduled annual principal maturities and interest are as follows (thousands of dollars):

	Principal	Interest	Total
2010	$ 106,775	$ 142,335	$ 249,110
2011	99,935	137,652	237,587
2012	105,925	132,637	238,562
2013	123,380	127,726	251,106
2014	132,685	122,028	254,713
2015 – 2019 (combined)	814,515	509,727	1,324,242
2020 – 2024 (combined)	808,760	325,054	1,133,814
2025 – 2029 (combined)	619,950	159,246	779,196
2030 – 2034 (combined)	215,430	58,123	273,553
2035	72,270	3,271	75,541
Total Requirements	$ 3,099,625	$ 1,717,799	$ 4,817,424

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 0.15 and 0.18 percent in effect at December 31, 2009 for the issue.

2009 Revenue Bonds Refunding and Extinguishments. In January 2009, NCGA extinguished $250.0 million of 2007 NCGA Series B Gas Project Revenue Bonds (NCGA Bonds). This bond extinguishment resulted in a current accounting gain of $26.9 million, which is included in Gain or Loss on Debt Extinguishment and Refundings in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets. Redeeming the bonds reduced the aggregate future debt service payments by $417.3 million.

In May 2009, SMUD redeemed $14.6 million of SMUD 1985 Subordinated Series ER Bonds. This bonds redemption resulted in a current accounting gain of $0.5 million, which is included in Gain or Loss on Debt Extinguishment and Refundings in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets. Redeeming the bonds reduced the aggregate future debt service payments by $16.3 million. In August 2009, NCGA extinguished $9.8 million of NCGA Bonds. This bond extinguishment resulted in a current accounting gain of $1.1 million, which is included in Gain or Loss on Debt Extinguishment and Refundings in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets. Redeeming the bonds reduced the aggregate future debt service payments by $16.2 million.

In August 2009, SCA issued $57.5 million of 2009 Series SCA Cogeneration Project Revenue Refunding Bonds. Proceeds from the 2009 bonds and $7.1 million of available funds were used to refund $67.8 million of the outstanding 1998 SCA 1998 revenue 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 $4.0 million, which is being amortized over the life of the refunding issue, and a current period loss of $0.2 million which is included in Gain or Loss on Debt Extinguishment and Refundings in the Consolidated Statement of Revenues, Expenses, and Changes in Net Assets. The 2009 refunding reduced future aggregate debt service payments by $15.1 million and resulted in a total economic gain of $4.9 million, which is the difference between the present value of the old and new debt service payments.

In August 2009, CVFA issued $48.9 million of 2009 Series CVFA Cogeneration Project Revenue Refunding Bonds. Proceeds from the 2009 CVFA bonds and $5.0 million of available funds were used to refund $55.2 million of the outstanding CVFA 1998 revenue 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 $3.6 million, which is being amortized over the life of the refunding issue, and a current period

loss of $0.07 million which is included in Gain or Loss on Debt Extinguishment and Refundings in the Consolidated Statement of Revenues, Expenses, and Changes in Net Assets. The 2009 refunding reduced future aggregate debt service payments by $10.8 million and resulted in a total economic gain of $4.0 million, which is the difference between the present value of the old and new debt service payments.

2009 Bond Issuances – In May 2009, SMUD issued $200 million of 2009 Series V Electric Revenue Bonds at a discount of $1.9 million. These bonds were issued as taxable Build America Bonds under the provisions of the American Recovery and Reinvestment Act of 2009. SMUD expects to receive a cash subsidy payment from the U.S. Treasury equal to 35 percent of the interest payable on the bonds which will be recorded as a component of Interest and Other Income, in the Consolidated Statements of Revenues, Expenses and Changes in Net Assets.

2008 Revenue Bonds Refunding and Redemptions. In March 2008, SMUD redeemed $12.0 million of SMUD 2001 Subordinated Series B Bonds. This bond redemption resulted in a current accounting loss of $0.1 million, which is included in Gain or Loss on Debt Extinguishment and Refundings 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, SMUD 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 SMUD 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, SMUD 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, SMUD 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 Gain or Loss on Debt Extinguishment and Refundings 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, SMUD 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 SMUD 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. SMUD 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.

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

Initial Notional Amount (thousands)	SMUD 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

SMUD 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 SMUD's 1997 Series K Electric Revenue Bonds. Under this swap agreement, SMUD pays a variable rate equivalent to the Bond Market Association (BMA) Index (0.25 percent at December 31, 2009) and receives fixed rate payments of 5.154 percent. In connection with the swap agreement, SMUD has a put option agreement, also with an initial notional amount of $131.0 million, which gives the counterparty the right to sell to SMUD, 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 SMUD. The term of both the swap and the put is equal to the maturity of the 1997 Series K Bonds.

Additionally, SMUD 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. SMUD 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 SMUD under the swap agreements are not secured by a pledge of revenues of SMUD's electric system or any other property of SMUD.

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

Initial Notional Amount (thousands)	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

NCGA has 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 (0.25 percent at December 31, 2009) plus an interest rate spread, as specified in each swap agreement. The total notional amount of the four swaps at December 31, 2009 was $408.6 million and was equivalent to the outstanding principal balance on the NCGA Bonds. The swaps are amortized over the life of their respective swap agreements in a manner corresponding to the principal repayment schedule of the NCGA 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 SMUD's Electric Revenue Bonds.

Variable Rate Bonds. SMUD's Variable Rate Bonds bear interest at weekly rates, ranging from 0.15 percent to 0.18 percent at December 31, 2009. SMUD can elect to change the interest rate period or fix the interest rate, with certain limitations. SMUD's Variable Rate Bonds can be put to SMUD's Trustee by the bondholders; however SMUD has in place a reimbursement agreement with Bank of America to enable SMUD to pay off the bonds over five years if the bonds are put. Accordingly, SMUD has recorded such bonds as Long-Term Debt, less amounts scheduled for redemption within one year.

Component Unit Bonds. The component units of SMUD have each issued bonds to finance their respective projects. The bonds of SPA, NCGA and SFA have limited recourse to SMUD. 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 SMUD in connection with the sale of gas or electricity to SMUD. The ability of SPA, NCGA, and SFA to service their debt is dependent upon the successful operation of the respective projects. The ability of SCA and CVFA to service their debt is no longer dependent upon the successful operation of the project, as SMUD is now required, under a "take-or-pay" contract to make payments sufficient to pay principal and interest and all other payments required to be made under CVFA and SCA's indenture of trust, regardless of the continued successful operation of the Project.

Callable Bonds. SMUD has $207.9 million of Electric System Revenue Bonds that are currently callable, all of which is subordinate debt and is composed of $10.0 million of fixed rate debt and $197.9 million of Variable Rate Demand Notes (VRDN's). SMUD has $1,380.5 million of bonds that become callable from 2011 through 2018, and these bonds can be called until maturity.

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

Covenants. SMUD'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 including a rate covenant to raise rates to maintain minimum debt service coverage.

SMUD has pledged future net electric revenues, component unit net project revenues, and net gas supply prepayment revenues to repay $3,099.6 million and $3,294.5 million at December 31, 2009 and 2008, respectively, in electric revenue, component unit project revenue and gas supply prepayment revenue bonds issued from 1992 through 2009. 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 SMUD's electrical sales, component unit project revenues, and gas supply prepayment revenues and are payable through 2035 at December 31, 2009 through 2033 at December 31, 2008. Annual principal and interest payments on the bonds are expected to require approximately 38 and 35 percent of net revenues for the years ending December 31, 2009 and 2008, respectively. The total principal and interest remaining to be paid on the bonds is $4,817.4 million and $5,045.2 million at December 31, 2009 and 2008, respectively. Principal and interest paid was $275.9 million for 2009, and $255.6 million for 2008. Total net revenues were $720.7 million for 2009 and $732.7 million for 2008.

NOTE 11. COMMERCIAL PAPER NOTES

SMUD issues Commercial Paper Notes (Notes) to finance or reimburse capital expenditures. At December 31, 2009 and 2008 Notes outstanding totaled $200.0 million. The effective interest rate for the Notes outstanding at December 31, 2009 was 0.3 percent and the average term was 114 days. SMUD has a $204.9 million letter of credit agreement, and there have not been any term advances under it.

The summarized activity of SMUD's Notes during 2009 and 2008 is presented below (thousands of dollars):

	Balance at beginning of Year	Additions	Reductions	Balance at end of Year
December 31, 2009	$ 200,000	$ -0-	$ -0-	$ 200,000
December 31, 2008	$ 150,000	$ 50,000	$ -0-	$ 200,000

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 2009 and 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 SMUD's debt. SMUD's electric revenue bonds, SCA bonds, and CVFA 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 of SPA and SFA 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. 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 SMUD's financial instruments are presented below. Market values may have changed significantly since December 31, 2009.

	December 31, 2009	
	Recorded Value	Fair Value
	(thousands of dollars)	
Investments, including cash and cash equivalents	$ 558,900	$ 558,900
Long-term debt	(3,117,342)	(3,149,721)
Interest rate swap and put agreements – net	(2,534)	(2,534)
Gas and electricity related derivatives – net	(171,269)	(171,269)
Asset Retirement Obligation	(158,817)	(158,817)

	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)	(3,197,088)
Interest rate swap and put agreements – net	(17,829)	(17,829)
Gas and electricity related derivatives – net	(161,017)	(161,017)

Fair Value Measurements. Effective January 1, 2008, SMUD adopted FASB ASC 820 as discussed in Note 3, which, among other things, requires enhanced disclosures about assets and liabilities carried at fair value. FASB ASC 820 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). SMUD 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. SMUD primarily applies the market approach for recurring fair value measurements, maximizing the use of observable inputs and minimizing the use of unobservable inputs. FASB ASC 980 allows SMUD 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).

SMUD 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, SMUD uses an internally developed valuation model utilizing short-term observable inputs.

SMUD values its ARO for Rancho Seco based on significant unobservable inputs (Level 3). During 2009, the ARO was updated to reflect new information and revise the estimated costs. The information used to develop the inputs was a combination of actual historical costs and published data with contingencies to account for uncertainties in future costs. There was no change in the methodology used from the prior estimate.

FASB ASC 820 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 ASC 820 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 SMUD'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. Level 3 fair values for asset retirement obligations are calculated by estimating future costs on the basis of published and historical data and including contingencies for uncertainty in future costs.

The following table sets forth by level within the fair value hierarchy SMUD's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2009 and 2008. As required by FASB ASC 820, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. SMUD'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, 2009			
	Level 1	Level 2	Level 3	Total
	(thousands of dollars)			
Derivative Financial Instrument Assets:				
Gas related agreements	$ 8,023	$ 22,115	$ -0-	$ 30,138
Electric related agreements	-0-	-0-	-0-	-0-
Interest rate related agreements	-0-	27,479	-0-	27,479
Total Derivative Financial Instrument Assets	$ 8,023	$ 49,594	$ -0-	$ 57,617
Derivative Financial Instrument Liabilities:				
Gas related agreements	$ 194,648	$ 275	$ 5,767	$ 200,690
Electric related agreements	-0-	717	-0-	717
Interest rate related agreements	-0-	30,013	-0-	30,013
Total Derivative Financial Instrument Liabilities	194,648	31,005	5,767	231,420
Asset Retirement Obligation Liability:				
Rancho Seco	-0-	-0-	158,817	158,817
Total Liabilities	$ 194,648	$ 31,005	$ 164,584	$ 390,237

	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
Interest rate 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
Interest rate 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, 2009 and 2008.

	December 31,	
	2009	2008
	(thousands of dollars)	
Derivative Financial Instrument		
Gas Related		
Asset balance at beginning of year – net	$ 13,753	$ 44,438
Purchases and settlements	(4,712)	(2,845)
Realized and unrealized gains (losses):		
Included in regulatory assets and liabilities	(14,808)	(27,840)
Transfers in (out) of Level 3	-0-	-0-
Derivative Financial Instrument		
Asset (Liability) balance at end of year – net	$ (5,767)	$ 13,753

The following table provides a reconciliation of changes in the fair value of the ARO classified as Level 3 in the fair value hierarchy from the table above as of December 31, 2009.

	December 31, 2009
	(thousands of dollars)
Asset Retirement Obligation	
Liability balance at beginning of year – net	$ 171,392
Accretion and expenditures	5,346
Adjustments:	
Included in regulatory assets and liabilities	(17,921)
Transfers in (out) of Level 3	-0-
Asset Retirement Obligation	
Liability balance at end of year – net	$ 158,817

Net assets for the period were not impacted by unrealized gains or (losses) relating to assets or liabilities still held at December 31, 2009.

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 SMUD's decommissioning plan, which delineates a phased process, and the first phase of physical work was completed in 2008.

In 2009, the NRC released all of the land under the Part 50 license for unrestricted use with the exception of the 1 acre fenced area around the Interim Onsite Storage Building (IOB) that houses the stored class B and C waste. This waste will be stored for an unspecified period pending availability of appropriate disposal sites. The facility operating license 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. SMUD 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 formally withdraw the application for licensing of Yucca Mountain as a high-level waste repository, essentially removing Yucca Mountain as an option for disposal of SMUD's used nuclear fuel. The DOE also announced in January 2010 the creation of a Blue Ribbon Commission to study alternatives for developing a repository for the nation's used nuclear fuel: the Commission is tasked with providing a final report on alternatives in two years or January 2012. At this time, there is no credible information available to determine when the DOE would remove the used nuclear fuel from the Rancho Seco facility. SMUD maintains a separately licensed on-site independent spent fuel storage facility (Storage Facility) which stores all of SMUD'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 SMUD's current estimate of its obligation for the cost of decommissioning under the requirements of FASB ASC 410, based on studies completed each year. Each year, SMUD evaluates the estimate of costs of decommissioning and there was a decrease in cost in the 2009 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, 2009	December 31, 2008
	(thousands of dollars)	
Active decommissioning	$ 26,309	$ 47,121
Spent fuel management	132,508	124,271
Total ARO	$ 158,817	$ 171,392
Less: current portion	(6,913)	(6,913)
Total Non-current portion of ARO	$ 151,904	$ 164,479

The summarized activity of the Rancho Seco ARO during 2009 and 2008 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 SMUD performing the decommissioning activities.

	December 31, 2009	2008
	(thousands of dollars)	
ARO at beginning of year	$ 171,392	$ 191,744
Accretion	7,416	8,475
Expenditures	(2,070)	(30,677)
Change in Study	13,605	-0-
Annual adjustments	(31,526)	1,850
Total ARO	$ 158,817	$ 171,392

SMUD made no contributions to the Trust Fund in 2009 and contributed $2.6 million in 2008.

NOTE 14. PENSION PLANS

Defined Benefit Pension Plan. SMUD 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 SMUD 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. SMUD makes either the full or partial contributions required of SMUD employees on their behalf and for their account. SMUD is currently required to contribute 7.9 percent of payroll to the plan. The contribution requirements of plan members and SMUD are established and may be amended by PERS.

Annual Pension Cost. PERS payments made by SMUD in 2009 were $28.0 million. The Annual Pension Cost for 2009 was $27.4 million, and $0.6 million was paid by employees for purchase of additional service credits. Overall, SMUD paid $27.1 million, and employees paid $0.9 million. PERS payments made by SMUD 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, SMUD paid $26.8 million, and employees paid $1.2 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 2009 was determined by PERS as part of the annual actuarial valuation as of June 30, 2006; the contribution for the second half of 2009 was determined by PERS as part of the annual actuarial valuation as of June 30, 2007. 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
6/30/09	$ 27,372	100%
6/30/08	$ 27,405	100%
6/30/07	$ 24,225	100%

Funded Status and Funding Progress. As of June 30, 2008, the most recent actuarial valuation date, the plan was 98.6 percent funded. The actuarial accrued liability for benefits was $1,394 million, and the actuarial value of assets was $1,374 million, resulting in an unfunded actuarial accrued liability (UAAL) of $19.7 million. The covered payroll (annual payroll of active employees covered by the plan) was $180.4 million, and the ratio of the UAAL to the covered payroll was 10.9 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. SMUD 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 SMUD's employees contribute the funds. Each of SMUD'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 SMUD service and, accordingly, are not subject to the general claims of SMUD's creditors. SMUD 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 SMUD, nor its Board or officers have any liability for market variations in the Plans' asset values. SMUD 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. SMUD 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.

SMUD 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. SMUD does not match employee contributions, nor make contributions on behalf of its employees to the 457 Plan. Participating employees and SMUD made contributions into the Plans totaling $15.5 million and $1.6 million in 2009, respectively, and $16.0 million and $1.5 million in 2008, respectively.

NOTE 15. OTHER POST-EMPLOYMENT BENEFITS

SMUD provides postemployment healthcare benefits, in accordance with SMUD policy and negotiated agreements with employee representation groups in a single employer defined benefit plan, to all employees who retire from SMUD, and their dependents. SMUD also provides postemployment healthcare benefits to covered employees who are eligible for disability retirement. SMUD 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. SMUD 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 SMUD. The benefits, benefit levels, retiree contributions and employer contributions are governed by SMUD and can be amended by SMUD through its personnel manual and union contracts. At December 31, 2009, 2,557 postemployment participants, including retirees, spouses of retirees, surviving spouses, and eligible dependents, participated in SMUD's healthcare benefits program.

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. SMUD considers the following benefits to be OPEB: Medical, Dental and Long-Term Disability.

In 2007, the Governor of California signed Assembly Bill 554 into law, which allowed California public employers to join the California Employers Retiree Benefit Trust (CERBT) to prefund their OPEB obligations after January 1, 2008. In 2007, the Board approved a participation agreement with PERS for PERS to be the plan administrator for SMUD's OPEB trust. The participation agreement became effective in 2008, after which SMUD 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, and will provide medical, dental and long-term disability benefits for retirees and their beneficiaries. Any changes to these benefits would be approved by SMUD's Board and union contracts. To obtain a CERBT report, please contact PERS at 888-CALPERS.

The 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. SMUD contracted with PERS to administer its OPEB plan in 2008. SMUD has elected to net fund to PERS, so the contributions are the Annual Required Contribution (ARC) less the estimated cash flow for retiree benefit costs for each year. In 2008, SMUD funded its 2007 and 2008 net ARC plus estimated interest for 2007 to the CERBT trust. In 2009 and 2008, the net ARC contribution to the CERBT trust was $6.6 and $22.9 million, respectively. During 2009 and 2008, SMUD made the following healthcare benefit contributions by paying actual medical costs of $13.6 and $11.6 million, respectively.

Funding Status and Funding Progress. At December 31, 2009 and 2008, SMUD estimates that the actuarially determined accumulated postemployment benefit obligation was approximately $286.9 million and $264.0 million, respectively. The plan was 5.8 percent and 8.7 percent funded in 2009 and 2008, respectively. The covered payroll (annual payroll of active employees covered by the plan) is $197.8 million for 2009. The ratio of the UAAL to covered payroll is 136.7 percent for 2009.

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 2009, SMUD's annual OPEB Cost (expense) of $19.6 million was equal to the ARC.

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

	Year Ended December 31, 2009	2008
	(thousands of dollars)	
Annual required contribution	$ 19,582	$ 19,589
Interest on net OPEB obligation	-0-	1,075
Annual OPEB cost (expense)	19,582	20,664
Contributions made	(20,110)	(34,529)
Increase (decrease) in net OPEB obligation	(528)	(13,865)
Net OPEB obligation, beginning of year	-0-	13,865
Net OPEB obligation (asset), end of year	$ (528)	$ -0-

SMUD's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2009 and the two preceding years is as follows (thousands of dollars):

Year Ending	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation (Asset)
December 31, 2009	$ 19,582	103%	(528)
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, 2009 and 2008 actuarial valuation. Actuarial assumptions used a 7.75 percent investment rate of return (net of administrative expenses), and a 3.25 percent inflation assumption. For 2009, the actuarial assumptions for an annual healthcare cost trend growth of 14 percent for the current year, 9.5 percent for 2010, 8.5 percent for 2011, and declining 0.5 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 $16.6 million and $22.9 million in 2009 and 2008, respectively. 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

SMUD is exposed to various risks of loss related to torts, theft of and destruction to assets, errors and omissions, and natural disasters. In addition, SMUD is exposed to risks of loss due to injuries to, and illnesses of, its employees. SMUD 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. SMUD 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, certain coverages increased in 2009. In 2009, 2008 and 2007, the insurance policies in effect have adequately covered all settlements of the claims against SMUD. No claims have exceeded the limits of property or liability insurance in any of the past three years.

The claims liability is included as a component of Self Insurance, Deferred Credits and Other in the Consolidated Balance Sheets.

SMUD's total claims liability, comprising claims received and claims incurred but not reported, at December 31, 2009, 2008, and 2007 is presented below:

	2009	2008	2007
		(thousands of dollars)	
Workers' compensation claims	$ 9,605	$ 7,066	$ 6,434
General and auto claims	1,221	761	1,410
Short- and long-term disability claims	73	79	1,621
Claims liability	$ 10,899	$ 7,906	$ 9,465

Changes in SMUD's total claims liability during 2009, 2008 and 2007 is presented below:

	2009	2008	2007
		(thousands of dollars)	
Claims liability, beginning of year	$ 7,906	$ 9,465	$ 9,113
Add: provision for claims, current year	2,512	3,111	2,123
Increase/(Decrease) in provision for claims in prior years	3,763	(470)	2,264
Less: payments on claims attributable to current & prior years	(3,282)	(4,200)	(4,035)
Claims liability, end of year	$ 10,889	$ 7,906	$ 9,465

NOTE 17. COMMITMENTS

Electric Power Purchase Agreements. SMUD has numerous power purchase agreements with other power producers to purchase capacity, transmission, and associated energy to supply a portion of its load requirements. SMUD has minimum take-or-pay commitments for energy on some contracts. Certain contracts allow SMUD to exchange energy, received primarily in the summer months, when SMUD most needs the energy and to return energy during the winter months, or other subsequent periods. SMUD has numerous long-term natural gas supply, gas transportation and gas storage agreements with Canadian and U.S. companies to supply a portion of the consumption needs of SMUD's natural gas-fired power plants, which expire through 2031.

At December 31, 2009, the approximate minimum obligations for the take or pay contracts over the next five years are as follows:

	Electric	Gas
	(thousands of dollars)	
2010	$ 85,765	$ 20,882
2011	80,127	14,988
2012	35,925	10,676
2013	31,269	10,118
2014	31,310	10,118

At December 31, 2009, the approximate minimum obligations for the remaining contracts, assuming the energy or gas is delivered over the next five years, are as follows:

	Electric	Gas
	(thousands of dollars)	
2010	$ 127,190	$ 111,009
2011	129,657	133,806
2012	118,867	177,818
2013	114,738	176,201
2014	109,464	173,937

Contractual Commitments beyond 2014 – Electricity. Several of SMUD's purchase power contracts extend beyond the five-year summary presented above. These contracts expire between 2015 and 2033 and provide for power under various terms and conditions. SMUD estimates its annual minimum commitments under the take or pay contracts ranges between $26.6 million in 2015 and $4.1 million in 2033. SMUD estimates its annual minimum commitments under the remaining contracts, assuming the energy is delivered, ranges between $70.3 million in 2015 and $0.2 million in 2028. SMUD's largest purchase power source is the Western Area Power Administration (Western) Base Resource contract, whereby SMUD 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, SMUD's percentage share changes to approximately 25 percent. The Western contract expires on December 31, 2024.

Contractual Commitments beyond 2014 – Gas. Several of SMUD's gas transport and gas storage contracts extend beyond the five-year summary presented above. These contracts expire between 2015 and 2031 and provide for transportation and storage under various terms and conditions. SMUD estimates its annual minimum commitments under the take or pay contracts ranges between $10.1 million in 2015 and $1.2 million in 2031. SMUD estimates its annual minimum commitments under the remaining contracts, assuming the gas is delivered, ranges between $152.6 million in 2015 and $19.2 million in 2031.

Electric Power Price Swap Agreements. SMUD has entered into one variable to fixed rate swap with a notional amount totaling 92,400 megawatt hours (MWh) for the purpose of fixing the rate on SMUD's electric power purchases. This electric power price swap agreement results in the SMUD paying fixed rates of $77.72 per MWh. The swap agreement expires in September 2011.

Gas Price Swap Agreements. SMUD has entered into numerous variable to fixed rate swaps with notional amounts totaling 243,436,500 million British Thermal Units (mmbtu) for the purpose of fixing the rate on SMUD's natural gas purchases for its gas-fueled power plants and gas indexed electric contracts. These gas price swap agreements result in SMUD paying fixed rates ranging from $5.22 to $12.41 per mmbtu. The swap agreements expire periodically from January 2010 through December 2022.

Gas Transport Capacity Agreements. SMUD has numerous long-term natural gas transport capacity agreements with Canadian and U.S. companies to transport natural gas to SMUD'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 SMUD-owned pipeline capacity within California. The gas transport capacity agreements provide SMUD 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. SMUD also has an agreement for the storage of up to 2.33 million Dth of natural gas at a regional facility. The gas storage agreement was renewed in 2009 and expires in 2011.

NOTE 18. CLAIMS AND CONTINGENCIES

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 the Rancho Seco intertie point from July 2000 through June 2002. In September 2003, SMUD 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 SMUD's behalf for transactions with the California Independent System Operator (ISO) at this intertie point until June 2002, when SMUD 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.

SMUD believes that, even if the charges were appropriate, PG&E's delay in billing within a reasonable timeframe compromised SMUD's ability to modify its operations or scheduling procedures to eliminate or mitigate the charges. In October 2003 SMUD 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. SMUD estimates its maximum liability for this matter at $2.2 million; however, SMUD 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.

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 SMUD 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 SMUD's power sales from May 1, 2000 through June 20, 2001 (Refund Period) in the wholesale electricity markets operated by the ISO and the California Power Exchange (PX) under tariffs filed with the FERC. The California Parties allege that SMUD 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 U.S. Court of Appeals for the Ninth Circuit (Ninth Circuit). In April 2007, the California Parties filed a breach of contract claim in Los Angeles Superior Court (LA Superior Court) against the Governmental Entities, who filed demurrers in August 2007, which were denied in December 2007. The Governmental Entities filed a petition for writ of mandate in January 2008 with respect to the statute of limitations defense. In January 2008, the Governmental Entities filed an answer to the California Parties' complaint. In October 2008, the State Court of Appeals summarily dismissed the petition for writ of mandate.

Several status conferences were held throughout 2009. During the status conferences, the LA Superior Court bifurcated issues of liability and damages and set a liability trial for May 2010. In addition, the LA Superior Court set a schedule for an early trial readiness conference in April 2010. On February 1, 2010, The Governmental Entities filed a motion for summary judgment.

In this state court action, the California Parties are seeking damages from the Governmental Entities in the amount that the Governmental 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 SMUD, 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, SMUD expects that this amount would parallel the refund that SMUD would owe to the market if it were subject to refund liability. Accordingly, SMUD estimates that its potential refund liability ranges between no liability and approximately $13.5 million. Ultimately, SMUD 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, in January 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 SMUD's power sales into the ISO/PX markets during the Refund Period, as well as SMUD's bilateral power sales to the Department of Water Resources (DWR) through the California Energy Resource Scheduler (CERS). SMUD returned the claim as untimely in mid-January 2006.

In June 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 SMUD 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 SMUD's bilateral sales to CERS, the State Entities claim that SMUD 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.

SMUD 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 SMUD'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 SMUD, imposes further obstacles that the State Entities must overcome to prevail in litigation.

In January 2007, the State Entities filed its amended complaint and served it on SMUD. 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 SMUD's voluntary power sales to DWR and the ISO, for which DWR paid, 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 SMUD'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.

In February 2007, SMUD entered into a tolling agreement with the State Entities, under which the State Entities agreed to dismiss without prejudice its claim against SMUD 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 SMUD 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' complaint, the State Entities seek the difference between the market price paid to SMUD and the FERC-mitigated price. Accordingly, SMUD 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, SMUD estimates that this amount is approximately $72.0 million based on the FERC-mitigated price as of July 2004. Ultimately, SMUD does not believe that either party will be successful in pursuing the claims. Consequently, SMUD management believes that the outcome of these matters will not have a material adverse impact on SMUD's financial position or results of operations.

Fru-Con Construction Corporation Construction Matters. In August 2003, SMUD entered into a contract with Fru-Con Construction Corporation (Fru-Con) to construct SMUD'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 had previously made claims for comparably smaller amounts that had 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, SMUD and Fru-Con participated in negotiations to resolve disputes over both cost and delays in the CPP Project schedule. SMUD also notified Travelers in January 2005 about Fru-Con's defaults. The parties were unable to resolve the disputes to the satisfaction of SMUD and in February 2005, SMUD terminated its contract with Fru-Con on the basis of breach of contract by Fru-Con, and took steps to complete the CPP Project. In February 2005, SMUD 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 (State Court Action).

In March 2005, Fru-Con filed a complaint against SMUD in federal court, alleging breach of contract (Federal Court Action) and attempted to remove the State Court Action to federal court. In May 2005, the federal court granted SMUD's motion to remand, and transferred the State Court Action back to the Sacramento County Superior Court.

SMUD also pursued a claim against Travelers under the performance bond. In September 2005, Travelers denied SMUD's claim and filed a declaratory relief action in the same federal court as the Fru-Con Federal Court Action. SMUD filed a counterclaim in response to Travelers' lawsuit. In general, SMUD is seeking to recover from Travelers all of the damages it claims against Fru-Con, including attorneys' fees. Fru-Con's federal case has been consolidated with the Travelers lawsuit for purposes of discovery.

In June 2007, the Sacramento County Superior Court (Superior Court) issued a summary adjudication order upholding SMUD's right to terminate the contract, leaving for trial only the issue of the amount of damages owing by Fru-Con to SMUD. Fru-Con appealed the Superior Court order to the Court of Appeals. In September 2007, the California Supreme Court denied Fru-Con's Petition for Review seeking to overturn the Court of Appeals decision, which had denied their petition to reverse the Superior Court order.

The Superior Court trial commenced in January 2009. SMUD presented evidence at trial to support an award of $47.1 million net in damages, excluding interest and attorneys' fees, comprised of SMUD's cost to complete Fru-Con's scope of work ($38.8 million), contract liquidated damages ($8.2 million) and statutory damages for false claims ($153.0 thousand). This net total included offsets for Fru-Con's legitimate change order requests for out-of-scope work that Fru-Con actually performed prior to termination and the $7.8 million in retained funds held by SMUD. In contrast, Fru-Con presented evidence at trial that SMUD should not be awarded any damages, and instead that Fru-Con should be awarded roughly $45 million, inclusive of claims for extra work for change orders, delays and inefficiencies allegedly caused by SMUD, and attorneys' fees.

In April 2009, after nearly three months in trial, the case was submitted to the jury. In June 2009, the jury rendered a verdict awarding SMUD $42.2 million in damages, excluding interest and attorneys' fees ($35.6 million cost to complete, $6.6 million in liquidated damages, and $10.0 thousand for False Claims), and awarding Fru-Con $1.5 million for change orders.

In December 2009, following a hearing on motions for pre-judgment interest and attorneys fees, the Final Judgment on Verdict was issued. In addition to the $42.2 million in damages to SMUD, SMUD was awarded $13 million in prejudgment interest through the date of Judgment, and reduced Fru-Con's net award to $1.2 million, which offsets against SMUD's award, resulting in a net total of approximately $54 million, plus costs to be submitted. SMUD's request for attorneys' fees was denied.

In December 2009, Fru-Con filed motions for a mistrial and a judgment in Fru-Con's favor notwithstanding the verdict. On February 4, 2010, the judge issued his final ruling denying both motions. On February 8, 2010, Fru-Con filed a Notice of Appeal of the final judgment, including prejudgment orders and the order denying both post-judgment motions with the State Court of Appeals for the Third Appellate District.

Meanwhile, in September 2009, the Federal District Court handed SMUD a further procedural victory by issuing a Stay Order. This Stay Order puts a hold on the federal trial pending the final resolution of the state court proceedings. Effectively, the state judgment would then be binding on the federal court. In September 2009, Fru-Con filed an appeal of the Stay Order to the Ninth Circuit, followed by a similar appeal by Travelers. Fru-Con and Travelers also filed motions to expedite appeal and to consolidate. In October 2009, the Ninth Circuit ordered the appeals consolidated, but denied Fru-Con's and Travelers' motions to expedite the appeal, retaining the regular briefing schedule. Fru-Con and Travelers filed opening briefs the first week of January 2010 and SMUD's opposing briefs were filed the first week of February 2010.

SMUD management continues to believe that over the course of the state and federal appellate review proceedings and any follow-up trial court proceedings, SMUD is reasonably likely to be successful in refuting, at a minimum, a majority of Fru-Con's claims and to prevail in a majority of its claims against Fru-Con, as well as the surety Travelers. SMUD management also believes that the outcome of this matter will not have a material adverse impact on SMUD's financial position or results of operations.

Other Construction Matters. SMUD contracts with various other firms to design and construct facilities for SMUD. Currently, SMUD is party to various claims, legal actions and complaints on some of these construction projects. SMUD 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 SMUD's financial position or results of operations.

Environmental Matters. SMUD 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, SMUD 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 SMUD along with other electric utilities as potentially responsible parties. SMUD 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, SMUD's share of these contingent liabilities would increase and could be material. SMUD 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 SMUD's financial position or results of operations.

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

REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

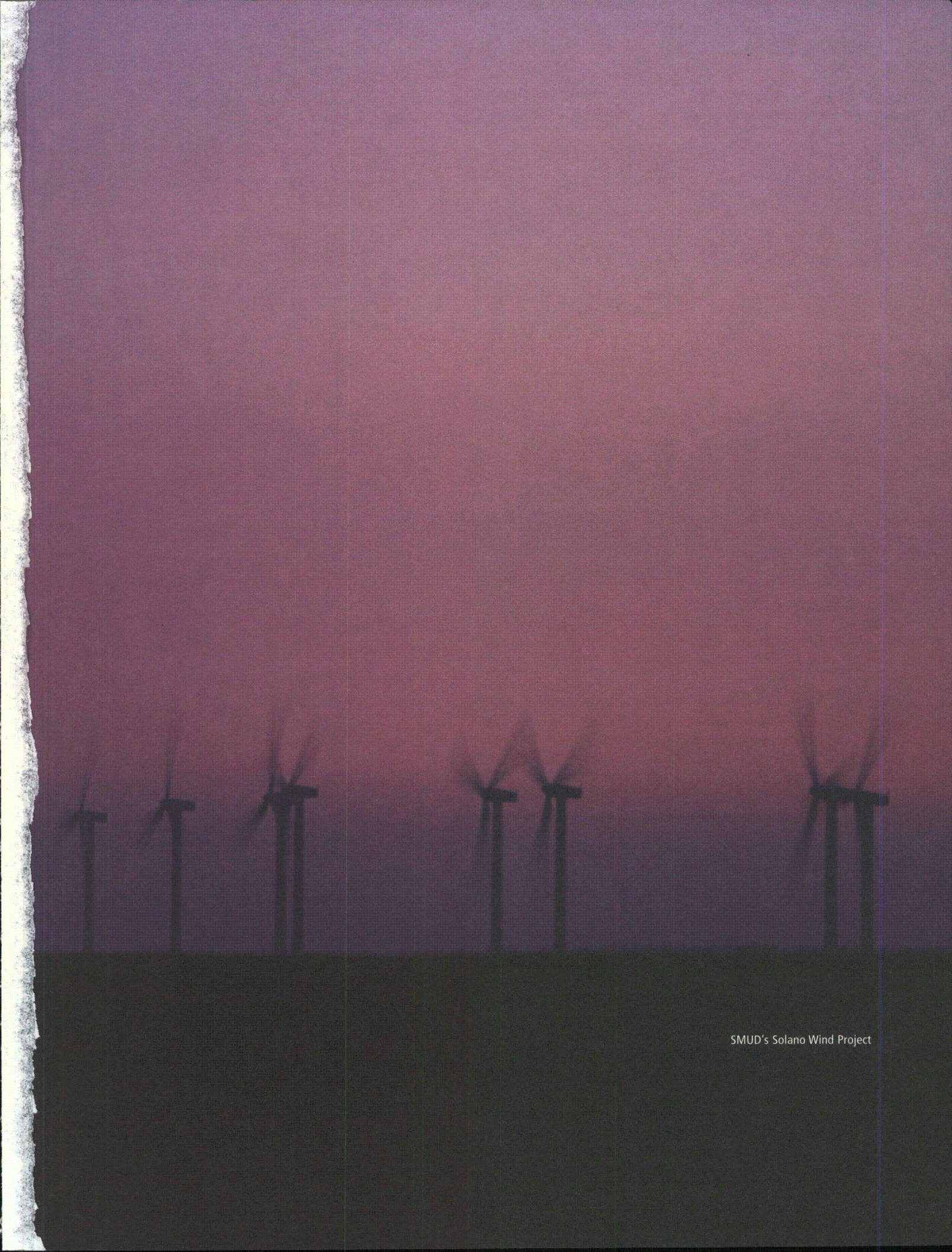
Schedules of Funding Progress

PERS Pension. The schedule of funding progress for PERS is presented below for the three most recent years for which SMUD 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)
6/30/08	$ 1,373,974	$ 1,393,705	$ 19,731	98.6%	$ 180,362	10.9%
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%

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

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
1/1/2009	$ 16,570	$ 286,874	$ 270,304	5.8%	$ 197,772	137%
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%



SMUD's Solano Wind Project

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